BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

In the Matter of	)	
	)	
Access Charge Reform	)	**CC Docket No. 96-262**
	)	
Price Cap Performance Review for Local Exchange Carriers	))	**CC Docket No. 94-1**
	)	
Low Volume Long Distance Users	)	**CC Docket No. 99-249**
	)	
Federal-State Joint Board On Universal Service	))	**CC Docket No. 96-45**

COMMENTS OF
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November 12, 1999

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EXECUTIVE SUMMARY

The CALLS Proposal Radically Restructures Federal Rates

The FCC should reject the proposal from a coalition[1] (Coalition for Affordable Local and Long Distance Service, "CALLS") – made up entirely of telecommunications companies – to radically alter the recovery of telecommunications costs in the federal jurisdiction.

The CALLS proposal would double the cap on the subscriber line charge (SLC) for primary lines. The industry estimates that the net increase in bottom-of-the-bill charges would be about $1.50 per month for primary residential lines. In addition, it would shift the Primary Interexchange Carrier Charge (PICC) and the Universal Service Fund (USF) from the carriers to consumers.

The proposal would also eliminate the Carrier Common Line Charge (CCL), by using the productivity factor to reduce that charge over time. As soon as the CCL is eliminated, the productivity factor would be eliminated and no further reductions in federal access charges would result from increasing productivity in the industry. The LECs would, however, be able to automatically increase rates to reflect inflation.

In addition, the proposal would settle an audit of the local exchange companies (LECs) which found billions of dollars of irregularities. Unfortunately for the consumer, the proposal does not impose any penalties, set rates at lower levels to reflect past overcharges, or lower rates to reflect phantom assets that are still embedded in the prices charged to consumers. In effect, the CALLS proposal wipes the slate clean.

The CALLS Proposal Will Harm The Majority Of Residential Consumers

The industry defends the CALLS proposal as "a form of social compact between the regulators and all market participants"[2] that "balances the public interests defined by the 1996 Act."[3] In truth the proposal is much more like the famous Washington D.C. tax game – "don't tax you, don't tax me, tax the guy behind the tree." In this case, the guy behind the tree is the typical American residential consumer whose long distance bill will go up as a result of the proposal when it should be going down.

[1] *Universal Service and Access Reform Proposal,* Coalition for Affordable Local and Long-Distance Service. For purposes of these comments, we refer to the rate proposal itself as the Proposal. We refer to the justification offered as CALLS.

[2] CALLS, p. 35.

[3] CALLS, p. 24.

The net effect of the CALLS proposal would be to give the long distance companies a free ride on the distribution plant of the local exchange carriers. The long distance companies would not pay for the facilities (loop plant) they use to provide the services that they sell to the public.

The CALLS proposal would increase the bottom-of-the-bill charges paid by residential consumers by about $2 billion and institutionalize another $2 billion in long distance company charges as line items sanctioned by the Federal Communications Commission. If the CALLS proposal is implemented, it would magnify the total Federal bottom-of-the-bill charges paid directly by consumers to local exchange companies to about $12 billion in the residential market alone. Of that total, over $7 billion will have been added to the bottom-of-the-bill charges after the passage of the 1996 Act. We do not think that this is what Congress had in mind as a balance of interests.

Studies claiming that all consumers will benefit from the CALLS proposal, such as the study paid for by CALLS but issued under the name of the Alliance for Public Technology (APT),[4] are incorrect because they are based on assumptions that are contradicted by pricing behavior in the industry.[5] The APT study assumes that long distance companies will pass through reductions in costs on a uniform per minute basis. The industry has not done so in the past nor does it commit to do so in the CALLS proposal. <u>The proposal does not even give a guarantee that all of the reductions in access charges will be passed through to consumers, not to mention a commitment to pass them through in a manner that ensures low-volume users will receive a fair share of any reductions.</u> The signatories agree only to "commit to meet with the FCC to review the effects."[6] Simply put, the APT study assumes that there is no price discrimination against low to average volume residential long distance consumers, when, in fact, price discrimination has been brutal.

Ironically, even if one assumes a uniform pass through, the APT analysis shows that about 85 percent of the so-called consumer benefit goes to businesses and upper income households. However, because price discrimination has been rampant in the long distance industry, the outcome will be much worse than that for the majority of consumers.

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[4] Pociash, Stephen B., *An Assessment of Consumer Welfare Effects of the CALLS Plan* (Joel Popkin and Company, October 25, 1999), p. 1, explains the interrelationship between APT, CALLS and the study.

[5] Joint Consumer Commentors have demonstrated that similarly unrealistic assumptions apply to several other recently released industry studies, particularly those by AT&T. *See* Reply Comments, Federal Communications Commission, <u>Notice of Inquiry</u>, Low-volume Long Distance Users, CC Docket No. 99-249 (October 20, 1999).

[6] Proposal, section 6.

The 70 million residential accounts with long distance usage below the mean are likely to suffer a $1 billion net increase in their long distance bills rather than a decrease because of the industry practice of price discrimination. The FCC's own Synthesis Proxy Cost Model, which it has recently applied to deliver increased payments to the large local exchange companies, indicates that these same households should be receiving a net reduction in the federal recovery of costs of at least $1.5 billion, not an increase.

The CALLS Proposal Should Be Rejected

The recommended increases in the subscriber line charge, the elimination of the PICC and CCL and the transformation of the universal service fund into line items are illegal, arbitrary and capricious, uneconomic and unfair.

Illegal:

- The uncompensated use of facilities violates section 254 (k) of the Telecommunications Act of 1996 by allowing IXCs to use shared facilities without paying for them. It is contrary to the long standing interpretation of the requirements for reasonable recovery of shared costs which stretches back 70 years to Smith v. Illinois.

- The CALLS proposal undermines the ability of the Commission to ensure that rates are just and reasonable by "settling" the audit dispute without rate reductions and by eliminating the productivity factors which would force rates to reflect declining costs in the future, while at the same time the proposal includes a mechanism for automatic rate increases.

- The proposal removes the obligation of telecommunications carriers to contribute to universal service, which contradicts the plain language of the Telecommunications Act of 1996.

Arbitrary and capricious:

- The CALLS proposal claims to set switching at forward-looking economic costs. The Commission has recently used forward-looking economic costs to establish the high cost payments for large LECs. Yet, the CALLS proposal does not set recovery of loop costs at forward looking economic levels. In fact, it increases rates even farther above the forward looking economic levels as determined by the very same model used to estimate switching costs and high cost loop costs.

- It is arbitrary and capricious to lower switching costs to reflect forward looking economic costs but raise loop rates, when the very same model indicates they should be reduced.

Uneconomic:

- ♦ The CALLS proposal ignores the integrated nature of modern telecommunications plant and the business plans of telecommunications companies to sell bundled local, long distance, and Internet services.

- ♦ The proposal would institutionalize federal charges for access that are far in excess of the economic cost of providing access as estimated by the Commission's own forward looking cost model and thereby insulate the charges from competitive pressures.

Unfair:

- ♦ The proposal shifts the burden of interstate cost recovery onto the shoulders of low-volume users and fails to ensure that bottom-of-the-bill line item increases will be offset in any reasonable way by long distance usage rate reductions.

- ♦ The CALLS proposal indemnifies the companies against future inflation by establishing a mechanism to increase rates, while foregoing future productivity offsets, which could lower rates.

The conclusion we draw from the legal, conceptual and empirical analysis is straightforward – the CALLS proposal should be rejected. Economic analysis demonstrates that the subscriber line charge is too high; public policy dictates that it should be reduced. In a world of efficient, multi-product telecommunications companies, claims that current fixed charges do not cover the federal share of loop costs are contradicted by the FCC's own cost analysis. Increases in unavoidable end-user charges, mandated by FCC action and tolerated by FCC inaction, run directly contrary to the congressional intention that basic service should bear no more than a reasonable share of joint and common costs.

The CALLS Proposal Does Not Provide A Basis For Negotiating Access Charge Reform And Universal Service Implementation

The CALLS proposal has been presented to the Commission as a "take it or leave it" proposition, with a recommendation that the Commission sidestep the consultative process with the Joint Board. This is an offer the Commission can easily refuse. Given the private, industry-only negotiations that gave birth to the proposal, its all or nothing nature, and the effort to avoid the joint federal-state process that Congress required, the proposal should not even be considered as a starting point for discussion.

Instead of increasing the average consumer's bill, as the CALLS proposal would, the FCC should start with the implementation of its forward looking economic cost model that would reduce the recovery of costs from residential consumers. The Joint Consumer Commentors have repeatedly and consistently argued that this would create adequate "head room" to reform access charges and rationalize universal service.

I. INTRODUCTION

A. JOINT COMMENTORS

The Texas Office of Public Utility Counsel (Texas OPC) is the state consumer agency designated by law to represent residential and small business consumer interests of Texas. The agency represents over 8 million residential customers and advocates consumer interests before Texas and Federal regulatory agencies as well as State and Federal courts.

The Consumer Federation of America (CFA) is the nation's largest consumer advocacy group, founded in 1968. Composed of over 250 state and local affiliates representing consumer, senior citizen, low-income, labor, farm, public power, and cooperative organizations, CFA's purpose is to represent consumer interests before the Congress and the federal agencies and to assist its state and local members in their activities in their local jurisdictions.

Consumers Union is a nonprofit membership organization chartered in 1936 under the laws of the State of New York to provide consumers with information, education and counsel about goods, services, health, and personal finance; and to initiate and cooperate with individual and group efforts to maintain and enhance the quality of life for consumers. Consumer's Union's income is solely derived from sale of *Consumer Reports*, its other publications and from noncommercial contributions, grants and fees.

These three organizations (hereafter, Joint Consumer Commentors) have participated in each of the dockets cited in the caption to this Notice of Proposed Rulemaking.[7] The notice is in response to a proposal from a coalition (Coalition for Affordable Local and Long Distance Service, "CALLS") made up entirely of telecommunications companies. It would radically alter the Commission's approach to access charges and harm the majority of residential consumers.[8]

B. THE CALLS PROPOSAL RADICALLY RESTRUCTURES FEDERAL RATES

1. A Sharp Increase in Bottom-of-the-Bill Charges

The CALLS proposal would double the cap on the subscriber line charge (SLC) for primary lines. The industry estimates that the net increase in bottom of the bill charges would be about $1.50 per month. In addition to the net increase, the proposal would shift the Primary Interexchange Carrier Charge (PICC) from the carriers to consumers. It would institutionalize the universal service fund payments as a line item on the bottom of the bill.

The proposal would also eliminate the Carrier Common Line Charge (CCL), by using the productivity factor to reduce that charge over time. As soon as the CCL is eliminated, the productivity factor would be eliminated and no further reductions in federal access charges would result from increasing productivity in the industry. The LECs, however, would be able to automatically increase rates to reflect inflation.

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[7] Federal Communications Commission, Notice of Proposed Rulemaking, Access Charge Reform, CC Docket No. 96-262, Price Cap Performance Review for local Exchange Carriers, CC Docket No. 94-1, Low Volume Long Distance Users, CC Docket No. 99-249 In the Matter of Federal-State Joint Board on Universal Service:, CC Docket No. 96-45 (September 15, 1999).

[8] *Universal Service and Access Reform Proposal*, Coalition for Affordable Local and Long-Distance Service. For purposes of these comments, we refer to the rate proposal itself and Proposal. We refer to the justification offered as CALLS.

The proposal would "settle" an audit of the local exchange companies (LECs) which found billions of dollars of irregularities. Unfortunately for consumers, the proposal would not impose any penalties or lower rates to reflect phantom assets that are still embedded in the prices charged to consumers, or even set the rates at lower levels to reflect the overcharges. The CALLS proposal wipes the slate clean.

2. The CALLS Proposal will harm the Majority of Residential Consumers

CALLS's proponents defend the proposal as "a form of social compact between the regulators and all market participants"[9] that "balances the public interests defined by the 1996 Act."[10] In truth the proposal is much more like the famous Washington D.C. tax game – "don't tax you, don't tax me, tax the guy behind the tree." In this case, the guy behind the tree is the typical American residential consumer whose long distance bill will go up as a result of the proposal when it should be going down.

The net effect of the CALLS proposal would be to give the long distance companies a free ride on the distribution plant of the local exchange carriers. The long distance companies would not pay for the facilities (loop plant) they use to provide the services that they sell to the public.

The CALLS proposal would increase the bottom-of-the-bill charges paid by residential consumers by about $2 billion and institutionalize another $2 billion in long distance company charges into line items sanctioned by the Federal Communications Commission (FCC or the

[9] CALLS, p. 35.

[10] CALLS, p. 24.

Commission). If the CALLS proposal is implemented, it would increase Federal bottom-of-the-bill charges paid directly by consumers to local exchange companies to about $12 billion in the residential market alone. This result is tantamount to a federal tax that is largely insulated from competitive pressures. Of this total, over $7 billion will have been added since the passage of the Telecommunications Act of 1996. We do not think this is the balance that Congress had in mind.

Studies claiming that all consumers will benefit from the CALLS proposal, such as the study paid for by CALLS but issued under the name of the Alliance for Public Technology (APT),[11] are incorrect because they are based on assumptions that are contradicted by pricing behavior in the industry.[12] The APT study assumes that long distance companies will pass through reductions in costs on a uniform per minute basis. The industry has not done so in the past nor does it commit to do so in the CALLS proposal. <u>The proposal does not even give a guarantee that all of the reductions in access charges will be passed through to consumers, not to mention a commitment to pass them through in a manner that ensures low volume users will receive a fair share of any reductions.</u> The CALLS signatories agree only to "commit to meet with the FCC to review the effects."[13] Simply put, the APT study assumes that there is no price discrimination against low- to average-volume residential long distance consumers, when, in fact, price discrimination has been brutal.

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[11] Pociash, Stephen B., *An Assessment of Consumer Welfare Effects of the CALLS Plan* (Joel Popkin and Company, October 25, 1999), p. 1, explains the interrelationship between APT, CALLS and the study.

[12] Joint Consumer Commentors have demonstrated that similarly unrealistic assumptions apply to several other recently released industry studies, particularly those by AT&T; *see* Joint Consumers Reply Comments, Federal Communications Commission, <u>Notice of Inquiry</u>, Low Volume Long Distance Users, CC Docket No. 99-249 (October 20, 1999).

[13] Proposal, section 6.

Ironically, even if one assumes a uniform pass through, the APT analysis shows that over 85 percent of the so-called consumer benefit goes to businesses and upper income households. Because price discrimination has been rampant in the long distance industry, the actual outcome will be much worse for the majority of consumers.

The 70 million residential accounts with usage below the mean are likely to suffer a $1 billion net increase in their long distance bills rather than a decrease because of the industry practice of price discrimination. The FCC's own Synthesis Proxy Cost Model, which it has recently applied to deliver increased high-cost payments to the large local exchange companies, indicates that these same households should be receiving a net reduction in the federal recovery of costs on the order of $1.5 billion.

3. The CALLS Proposal should be Rejected

The recommended increases in the subscriber line charge, the elimination of the PICC and CCL and the increase in, and transformation of, the universal service fund into a line item are illegal, arbitrary and capricious, uneconomic and unfair.

Illegal:

- ♦ The uncompensated use of facilities violates section 254 (k) of the Telecommunications Act of 1996 by allowing IXCs to use shared facilities without paying for them. It is contrary to the long standing interpretation of the requirements for reasonable recovery of shared costs which stretches back 70 years to Smith v. Illinois.

- ♦ The CALLS proposal undermines the Commission's ability to ensure that rates are just and reasonable by "settling" the audit dispute without rate reductions and by eliminating the productivity factors which would force rates to reflect declining costs in the future. At the same time, the proposal includes a mechanism for automatic rate increases.

- ♦ The proposal removes the obligation of telecommunications carriers to contribute to universal service, which contradicts the plain language of the Telecommunications Act of 1996 (the Telecommunications Act or the 1996 Act).

Arbitrary and capricious:

- ♦ The CALLS proposal claims to set switching at forward-looking economic costs. The Commission has recently used forward-looking economic costs to establish the high cost payments for large LECs. Yet, the CALLS proposal does not set recovery of loop costs at forward looking economic levels. In fact, it increases rates well above the forward-looking economic levels, as determined by the very same model used to estimate costs of switching and high-cost loops.

- ♦ It is arbitrary and capricious to lower switching costs to reflect forward-looking economic costs but raise loop rates, when the very same model indicates they should be reduced.

Uneconomic:

- ♦ The CALLS proposal ignores the integrated nature of modern telecommunications plant and the business plans of telecommunications companies to sell bundled local, long distance, and Internet services.

- ♦ The proposal would institutionalize federal charges for access that are far in excess of the economic cost of providing access as estimated by the Commission's own forward-looking cost model and would insulate a huge revenue stream from competitive pressures.

Unfair:

- ♦ The proposal shifts the burden of interstate cost recovery onto the shoulders of low-volume users.

- ♦ It indemnifies the companies against future inflation by establishing a mechanism to increase rates, while foregoing future productivity offsets, which could lower rates.
- ♦ It fails to ensure that bottom-of-the-bill line item increases will be offset in any reasonable way by long distance usage rate reductions.

The conclusion we draw from the legal, conceptual and empirical analysis is straightforward – the CALLS proposal should be rejected. Economic analysis demonstrates that the subscriber line charge is too high; public policy dictates that it should be reduced. In a world of efficient, multi-product telecommunications companies, claims that current fixed charges do not cover the federal share of loop costs are contradicted by the FCC's own cost analysis. Increases in unavoidable end-user charges, mandated by FCC action and tolerated by FCC inaction, run directly contrary to the congressional intention that basic service should bear no more than a reasonable share of joint and common costs.

4. The CALLS Proposal does not Provide a Basis for Negotiating Access Charge Reform and Universal Service Implementation

The CALLS proposal has been presented to the Commission as a "take it or leave it" proposition, with a recommendation that the Commission sidestep the consultative process with the Joint Board. This is an offer the Commission can easily refuse. Given the private, industry-only negotiations that gave birth to the proposal, its all or nothing nature, and the effort to avoid the joint federal-state process that Congress required, the proposal should not even be considered a starting point for discussion.

Instead of increasing the average consumer's bill, as the CALLS proposal would, the FCC should start with the implementation of its forward-looking economic cost model that would reduce the recovery of costs from residential consumers. The Joint Consumer Commentors have repeatedly and consistently argued that this would create adequate "head room" to reform access and rationalize universal service.

C. OUTLINE OF THE COMMENTS

The remainder of these comments is organized as follows. We will first examine the fundamental economic question of the nature of loop costs. We then consider the implications of basing federal cost recovery on forward-looking economic costs, as CALLS proposes for switching and the Commission has recently done for the large LEC high-cost fund. Next we examine several other elements in the CALLS proposal that call its legality into question. Finally, we consider the equity issues and the impact on low-volume consumers.

II. THE ECONOMIC AND LEGAL NATURE OF LOOP COSTS

A. SHARING OF COSTS BETWEEN SERVICES THAT USE JOINT AND COMMON FACILITIES ACROSS JURISDICTIONS REMAINS SOUND ECONOMIC AND PUBLIC POLICY.

Conceptual definitions of costs, analysis of the historic patterns of investment and current, real world activity all indicate that the distribution plant is a shared facility whose costs should be recovered from all services that use it.

1. Conceptual Definitions of Cost

Joint Commentors have consistently argued that the loop is a common cost for all telecommunications services that utilize it. In our universal service comments we made the following observations:

> The loop is a telecommunications facility used to complete all telephone calls -- local, intraLATA long distance, and interLATA long distance. It is also used to provide enhanced services. It is impossible to complete an interLATA long distance call without a loop. When the loop is in use to complete an interLATA long distance call, it cannot be used to complete another call.[14]

> In its Local Competition comments, Texas OPC defined these costs as follows:

> Joint cost: Costs incurred in the provision of two or more services, that are not captured in the incremental costs of each service individually when the services are produced in fixed proportions

> Common cost: Costs, incurred in the provision of two or more services, that are not captured in the incremental costs of each service individually when the services can be produced in variable proportions.

> Shared cost: Generic terms for costs that are shared between two or more services that are not captured in the incremental costs of each service individually.[15]

The Commission has adopted a cost and pricing methodology that recognizes the fundamental economics of the modern telecommunications network. This approach involves (1) the recognition of the telecommunications network as a multi-product undertaking exhibiting strong economies of scale and scope; (2) the treatment of the loop as a common cost; and (3) the comprehension of competitive market behavior. The economic evidence that the

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[14] "Initial Comments of the Texas Office of Public Utility Counsel," In the Matter of Federal-State Joint Board on Universal Service, CC Docket No. 96-45, April 12, 1996, p. 6.

[15] Initial Comments of the Texas Office of Public Utility Counsel," In the Matter of Implementation of Local Competition Provisions in the Telecommunications Act of 1996, CC Docket No. 96-98, May 16, 1996, pp. 21-22.

telecommunications network is a multi-product enterprise enjoying economies of scale and scope is overwhelming.

- On the supply-side all long distance calls use the network exactly the same way local calls do. Vertical services (like Call Waiting, Call Forwarding and Caller ID) are supported by all parts of the network. Basic service accounts for about one-quarter of total revenues generated per line because the line is shared by an ever-increasing array of services.

- The demands on shared facilities are likely to accelerate as advanced services begin to share in the use of these facilities.

- On the demand-side, customers expect to receive long distance service when they order telephone service. Vertical services are strong complements of basic service. If a provider sells basic service to a customer, competitors are very unlikely to sell that customer Call Waiting.

- Companies are eager to sell local service and long distance service bundled together.[16] One-stop shopping is an integral part of providers' business plans. In such a bundle, why is local cost the "cost causer", as the LECs and IXCs claim?

A reasonable basis to determine the allocation of shared costs is to analyze the facilities and functionalities necessary and actually used in the production of goods and services. In order to produce a long distance call IXCs need distribution plant, as well as switching plant and transport plant. Instead of basing economic analysis on a guess about what consumers really wanted when they purchased a bundle of services, the Commission should rely on a "service pays" principle. That is, services that use facilities should be considered to benefit from the deployment of those facilities and every service that uses a facility should help pay for it.

2. Historic Patterns of Investment Reveal the Fallacy of Attributing Loop Costs to only Basic Local Service

[16] Providers are also intensely interested in bundling many more services, such as Internet and data services, in addition to local and long-distance calling.

Historical analysis of why telecommunications investments were actually made shows that most telecommunications technologies were deployed for and used by business customers first. Hence, it is more reasonable to assume that those customers caused the investment. History shows that the integration of the long distance network into the local network (they actually started as two separate networks) raised the cost of the integrated network. Since the integrated network costs more as a result of the addition of long distance, it is reasonable to assume that long distance causes costs in the integrated network. In other words, complaints that business customers and long distance users pay too much actually ignore the historic pattern of cost causation.

Now that the companies are intensely competing to sell bundles of services, the fiction that local service causes the loop cost should be put to rest once and for all. In truth, since the first decade of this century, the network, including the loop, has been consciously designed to serve local and long distance. Long distance was not an afterthought; it was always a forethought, included in the design, development and deployment of the network. Vertical services have been included in economic analyses of network design and architecture for over a decade.

Although historical analysis demonstrates the fallacy of attributing loop costs to only basic local service, it is clear that efforts to unravel the network into cost causation categories are difficult. For that reason, the analysis of costs should be based on the only footing on which sensible economic analysis can be launched -- an assessment of the product, not the psychology of the customer. Regulators should analyze the facilities and functionalities necessary and actually used in the production of goods and services. They should rely on a service pays principle. That is, services that use facilities should be considered to cause the deployment of those facilities. Assumptions about prime movers are arbitrary. There should be no free rides; every service that uses a facility should be required to share in the recovery of the cost of that facility on a reasonable basis.

- As a matter of economics, costs for joint and common facilities should be recovered on the basis of the nature and quality of use that each service makes of those facilities.

- As a matter of public policy from a universal service docket perspective, recovery of joint and common costs should be structured in such a way as to promote universal service by keeping basic service affordable. Adding line items to the bottom of the bill or increasing them makes connectivity to the network more expense and less affordable.

3. Real World Pricing Behavior

Although some theoretical economists chafe at the thought of recovering shared costs across a range of products, common sense and real world experience demonstrates that this is the way markets work. For example, one of the Regional Bell Operating Companies made this argument in the federal universal service proceeding.

> The Telecommunications Act of 1996 does not require the Commission to replace any, or all, of the contributions to joint and common costs in the interstate access charge system with universal service funding...

They do not require the Commission to eliminate all, or even a major portion, of the contributions to joint and common costs in the interstate access charge system with a universal service funding mechanism, if those contributions do not preserve or advance universal service...

As a practical matter, the Commission must construe Section 254 in this way because it is neither possible, nor desirable, to create a rate structure for telecommunications services that reflects the true economic cost of serving each customer. The costs of service for a particular customer vary by the type of facilities provided, the customers' location, the volume of service, the short run and/or long run effect on capital deployment, and a host of other factors that change constantly. For this reason, a carrier defines a class of customers and develops averaged rates for the entire class. Even if the carrier disaggregates its rates by geography, time of day, or volume, the rate level is the same for the group of customers in the disaggregated category. This means that some customers in the category will pay more than the cost of the service, and the excess revenues from these customers subsidize other customers that are paying rates that do not recover their costs. Moreover, marketing considerations often dictate that rates for some services will directly subsidize rates for other services. For instance, supermarkets do not charge customers for parking, but recover the cost of parking in the price for groceries. They do this because it is a more effective way of encouraging customers to shop...

Thus, even in a perfectly competitive market, variable amounts of contribution to joint and common costs, and cross-subsidies between services, will always exist. Such pricing practices are not inconsistent with Section 254 unless they represent direct subsidies for universal service. [17]

In a similar proceeding in Texas, one of the potential competitors also made the point that a common sense understanding of economic behavior requires the recovery of costs across all services that share facilities.

In response to comments filed by MCI, Sprint and SWBT, TCG reiterates its strong support of the Commission's recommendation to calculate the subsidy requirements as the difference between total revenue per line and the forward-looking cost of those services rather than the difference between basic service rates and the cost of basic service. Such an approach is simply common sense and

[17] "NYNEX Comments," before the Federal Communications Commission, In the Matter Of Federal-State Joint Board on Universal Service, CC Docket No. 96-45, April 12, 1996, pp. 3, 4, 5.

recognizes the fact that telephone subscribers buy much more than basic service and generate far more revenue for their local service provider than the rates for basic service and the subscriber line charge. Indeed, to the extent that rates for basic service do not cover the cost of basic service (forward-looking or otherwise), the shortfall may be more than overcome by profits from discretionary services. The basic service rates, therefore, are no more than a loss leader for the provider, used to attract the customer so that the provider can sell him other, more profitable products and services.

It is also important to realize that discretionary services (e.g., call forwarding, call waiting, call answering) and access to a long-distance provider can be provided to that customer only by the customer's basic service provider. That is, once a customer selects a local service provider, that provider captures the *exclusive* right to sell that customer additional services. The Commission has correctly recognized, therefore, that subscribers to basic service are much more valuable to their carriers than the rates for basic service would imply, and that such revenue opportunities should be taken into account when calculating the support requirement.

Including such revenue in the benchmark both prevents a windfall from accruing to the ILECs and allows the marketplace to establish cost-based rates for all services including access. The windfall is prevented because a higher benchmark produces a smaller universal service fund, adjusted automatically for the revenue from access and vertical services. Cost-based rates will result from competition among local service providers for the entire package of services. It is important to realize that the telecommunications industry is extremely dynamic and costs will continue to decline. Competition will only accelerate this trend of declining cost reducing the need for universal service support. Moreover, because a competitive marketplace is the only real guarantor of cost-based prices, there is no need for the commission to intervene to "guess" at what costs ought to be.[18]

Moreover, the SLC and other fixed charges make no sense in a competitive market when competitors sell bundled local, toll, and long distance service. The fictions that the FCC has established among these "classes" of service will no longer be relevant and will be unable to exist in a competitive market where the line has been blurred between jurisdictional offerings.

[18] "Reply Comments of Teleport Communications Houston, Inc. and TCG Dallas Concerning Proposed Rules on Universal Service Fund Issues," before the Public Utility Commission of Texas, Investigation of Universal Service Issues, Project No. 14929, October 10, 1997.

Competitors will not be selling "local" service or "long distance"; they are and will be selling a bundled package of telephony along with cable, data and Internet services.

B. LEGAL PRINCIPLES

1. Federal and State Law

The Telecommunications Act of 1996 certainly understood the economics of the industry and sought efficient entry across a broad range of services.

- The Act promotes the deployment of advanced telecommunications services and information technologies and insists on a sharing of joint and common costs.
- The Act repeatedly recognizes that advanced services and basic service are linked.
- The Act recognizes that competitive and non-competitive services will be commingled on the network and its purpose is to advance this multi-product network.

The law directly addresses the revenue responsibility of these various services. The cross-subsidy and joint cost language of 47 USC 254 (k) addresses this point.

> Subsidy of Competitive Service Prohibited – A telecommunications carrier may not use services that are not competitive to subsidize services that are subject to competition. The Commission, with respect to interstate services, and the States, with respect to intrastate services, shall establish any necessary cost allocation rules, accounting safeguards, and guidelines to ensure that services included in the definition of universal service bear no more than a reasonable share of the joint and common costs of facilities used to provide those services.

This policy recognizes two distinct steps that are necessary to have fair and efficient pricing in an emerging, partially competitive environment -- a strict prohibition on below cost pricing and a reasonable recovery of joint and common costs across services that share facilities.

The Conference Report states this principle more vigorously. The Conference Committee Report clarifies the standard for cost allocation by adopting the Senate report language --

> The Commission and the states are required to establish any necessary cost allocation rules, accounting safeguards, and other guidelines *to ensure that universal service bears no more than a reasonable share (and may bear less than a reasonable share)* of the joint and common facilities used to provide both competitive and noncompetitive services. [19]

In pursuit of universal basic service, this language establishes a reasonable share of joint and common costs allocated to basic service as an *upper* limit.

The FCC, the states, and the courts have found consistently and repeatedly that the loop is a common cost. The courts recognized this almost three quarters of a century ago in Smith v. Illinois.[20] Many of the states have formally recognized this in comments in federal proceedings,[21] and in their own cost dockets.[22]

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[19] Conference Report, p. 129, *emphasis added*.

[20] 282 U.S. 133 (1930).

[21] Two of the Regional Bell Operating Companies take this point of view (Bell Atlantic and NYNEX), as do a number of state regulators: the Texas Public Utility Commission, the Nebraska Public Service Commission, the New Hampshire Public Utilities Commission, the New Mexico State Corporation Commission, the Utah Public Service Commission, the Vermont Department of Public Service and Public Service Board, and the Public Service Commission of West Virginia. In the Matter of Federal-State Joint Board on Universal Service, Before the Federal Communications Commission, FCC 96-93, CC Docket No. 96-45, April 12, 1996 p. 18; "Comments of the State of Maine Public Utility Commission, the State of Montana Public Service Commission". Virtually all other Consumer Advocate commentors share this view in their initial comments. "Comments of the Idaho Public Service Commission" In the Matter of Federal-State Joint Board on Universal Service, Before the Federal Communications Commission, FCC 96-93, CC Docket No. 96-45, April 12, 1996, p. 17; "Comments of the Public Utility Commission of Texas" In the Matter of Federal-State Joint Board on Universal Service, Before the Federal Communications Commission, FCC 96-93, CC Docket No. 96-45, April 12, 1996, p. ii; "Initial Comments of the Pennsylvania Public Utility Commission to the Notice of Proposed Rulemaking and Order Establishing Joint Board" In the Matter of Federal-State Joint Board on Universal Service, Before the Federal Communications Commission, FCC 96-93, CC Docket No. 96-45, April 12, 1996, p. 7.; Florida, p. 22; "Initial Comments of the Virginia Corporation Commission," In the Matter of Federal-State Joint Board on Universal Service, Before the Federal Communications Commission, FCC 96-93, CC Docket No. 96-45, April 12, 1996, p. 5; "Comments of the Staff of the Indiana Utility Regulatory Commission" In the Matter of Federal-State Joint Board on Universal Service, Before the Federal Communications Commission, FCC 96-93, CC Docket No. 96-45, April 12, 1996, p. 9.

[22] "Report of Glenn P. Richardson, Senior Hearing Examiner, Application of GTE South Incorporated For Revisions to

The failure to take legitimate joint and common costs into account would frustrate the purposes of the 1996 Act. Allowing incumbents to recover joint and common costs excessively from fixed charges on the bottom of the bill discourages efficiency and frustrates competition by allowing incumbents to price more competitive services at an artificially low level. Contrary to the basic premise of the 1996 Act, allowing incumbents to recover an unreasonable share of joint and common costs from basic service insulates incumbents unfairly from market forces.

In the residential sector alone, the CALLS proposal would transform over ten billion dollars of the cost of distribution facilities into a bottom-of-the-bill mandated federal payment to local exchange companies. Once these costs appear on the bottom of the bill, they tend to become institutionalized and are much less likely to be competed away. These line items become a floor that the industry starts with, rather than a cost to be attacked by competition.

Its Local Exchange, Access and IntraLATA Long Distance Rates, Commonwealth of Virginia State Corporation Commission, Case No. PUVC950019, March 14, 1997, p. 84; Application of the Mountain States Telephone and Telegraph Company dong Business as U.S. West Communications, Inc., for Approval of a Five-Year Plan for Rate and Service Regulation and for a Share Earnings Program, Colorado Public Utilities Commission, Docket Nos. 90a-665T, 96A-281T, 96S-257T, Decision No. C97-88, January 5, 1997, pp. 42-43; Decision and Order Rejecting Tariff Revisions, Washington Utilities and Transportation Commission v. U.S. West Communications Inc., Docket No. UT-950200, April 11, 1996 pp. 83-84; Department of Utility Controls' Investigation Into the Southern New England Telephone Company's Cost of Providing Service, Department of Public Utility Control, Docket No. 94-10-01, June 15, 1995, pp. 24-25; Report and Order, In Re: US West Communications, Inc., Utah Public Service Commission, Docket No. 95-049-05, November 6, 1995, p. 95; Final Decision and Order, In Re US West Communications Inc., Iowa Utilities Board, Docket No. RPU-95-10, May 17, 1996, p. 295, 306; Final Decision and Order, In Re US West Communications Inc., Iowa Utilities Board, Docket No. RPU-94-1, November 21, 1994; In the Matter of the Application of GTE Southwest Incorporates and Contel of the West, Incorporated to Restructure Their Respective Rates, New Mexico State Corporation Commission, Docket NO. 94-291-TC, Phase II, December 27, 1995, pp. 11, 14-15; New England Telephone Generic Rate Structure Investigation, New Hampshire Public Utilities Commission, March 11, 1991, DR 89010, slip, op., pp. 39-40; Order No. 18598, Re: Investigation into Nontraffic-Sensitive Cost Recovery, Florida Public Service Commission, 1987; Docket No. 860984-TP, pp. 258, 265-266; Order No. U-15955, Ex Parte South Central Bell Telephone Company, Docket No. 1-00940035, Louisiana Public Service Commission, September 5, 1995, p. 12; In Re Formal Investigation to Examine and Establish Updated Universal Service Principles and Policies for Telecommunications Services in the Commonwealth, Docket No. 1-00940035, September 5, 1995, p. 12; In the Matter of a Summary Investigation into IntraLATA Toll Access Compensation for Local Exchange Carriers Providing Telephone Services Within the State of Minnesota, Minnesota Public utilities Commission, Docket No. P-999/CI-85-582, November 2, 1987, p. 33.

2. The FCC's Conceptual Paradigm for Cost Recovery

In a series of recent rulings to implement the 1996 Telecom Act, the FCC has constructed a comprehensive paradigm that starts from the fundamentally correct premise that the loop is a shared cost. There should be no doubt that this is the correct treatment of loop costs and alternatives should be clearly and loudly rejected.

The FCC began in the local competition docket by recognizing that the loop is a shared cost of local, long distance and the other services that use the loop. As discussed above, separate telecommunications services are typically provided over shared network facilities, the cost of which may be joint or common with respect to some services.

> The costs of local loops and their associated line cards in local switches, for example, are common with respect to interstate access service and local exchange service, because once these facilities are installed to provide one service they are able to provide the other at no additional cost.[23]

The FCC followed that decision with its proposed rulemaking on access charge reform, in which it reaffirmed the observation that the loop is a common cost.

> For example, interstate access is typically provided using the same loops and line cards that are used to provide local service. The costs of these elements are, therefore, common to the provision of both local and long distance service.[24]

The FCC applied this conclusion in its decision to convert the Common Carrier Line (CCL) charge into a flat rate charge to cover loop costs.

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[23] Federal Communications Commission, First Report and Order: Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, CC Docket No. 96-98, ¶678.

[24] Federal Communications Commission, In the Matter of Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Transport Rate Structure and Pricing, End User Common Line Charges: Notice of Proposed

> We reject claims that a flat-rated, per line recovery mechanism assessed on IXCs would be inconsistent with section 254 (b) that requires equitable and nondiscriminatory contribution to universal service by all telecommunications providers. The PICC is not a universal service mechanism, but rather a flat-rated charge that recovers local loop costs in a cost causative manner.[25]

In the reform of the separations process, the FCC has stated the economic reasoning and analysis which underpins this treatment of the loop.

> Nearly all ILEC facilities and operations are used for multiple services. Some portion of costs nonetheless can be attributed to individual services in a manner reflecting cost causation. This is possible when one service, using capacity that would otherwise be used by another service, requires the construction of greater capacity, making capacity cost *incremental* to the service. The service therefore bears a causal responsibility for part of the cost. The cost of some components in local switches, for example, is incremental (i.e. sensitive) to the levels of local and toll traffic engaging the switch. Most ILEC costs, however, cannot be attributed to individual services in this manner because in the case of joint and common costs, cost causation alone does not yield a unique allocation of such costs across those services. The primary reason is that shared facilities and operations are usually capable of providing at least one additional service at no additional cost. In such instances, the cost is *common* to the services. For example, the cost of a residential loop used to provide traditional telephony services usually is common to local, intrastate toll, and interstate toll services. In a typical residence, none of these services individually bears causal responsibility for loop costs because no service places sufficient demands on capacity to warrant installation of a second loop. Another reason why a relationship may not exist between cost and individual services is that some shared facilities or operations provide services in fixed proportion to each other, making the cost *joint* with respect to the services. ILEC billing costs, for example, tend to be joint with respect to local,

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Rulemaking, CC Docket Nos. 96-262, 94-1, 91-213, 95-72, ¶ 237.

[25] Federal Communications Commission, In the Matter of Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Transport Rate Structure and Pricing, End User Common Line Charges: First Report and Order, CC Docket Nos. 96-262, 94-1, 91-213, 95-72, ¶ 104.

state toll, and interstate toll services. For the majority of bills rendered, billed charges always include all three services. The fixed combination of services makes it impossible for one service to bear responsibility for billing costs...

Both incremental cost and stand-alone cost (which are usually expressed per unit of output) are greatly affected by the way we choose to define the increment and the service class. The incremental cost of carrying an additional call from residences to end offices, for example, is zero if the residences are already connected to end offices, but the incremental cost of establishing such connections is the cost of the loops. [26]

Moreover, the importance of ensuring the correct loop allocation cannot be overemphasized. As the FCC notes, the proper identification of loop costs is critical to telecommunications pricing because loop costs constitute almost half of all costs of local exchange carriers.[27] For example, ARMIS data indicate that loop plant investment in 1996 was 49% of total plant investment.

Most importantly, the FCC's methodology for estimating costs of basic service for purposes of identifying high cost areas is consistent with its logic of properly allocating loop costs. Two of the ten criteria it establishes for specification of a cost model require similar treatment of joint and common costs:

(2) Any network functionality or element, such as loop, switching, transport, or signaling, necessary to produce supported services must have an associated cost...

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[26] Federal Communications Commission, In the Matter of Jurisdictional Separations Reform and Referral to the Federal-State Joint Board, Notice of Proposed Rulemaking, CC Docket No. 80-286, November 10, 1997 (hereafter, Separations NPRM), pp. 14-15.

[27] Separations NPRM, p. 16

> (7) A reasonable allocation of joint and common costs must be assigned to the cost of supported services. This allocation will ensure that the forward-looking economic cost does not include an unreasonable share of joint and common costs for non-supported services.[28]

Having concluded that the loop is a shared cost, we turn to the question of how the share of those costs that are allocated to uses that fall within the federal jurisdiction should be recovered. The CCL is a charge to cover the use of a joint and common facility, the loop.

If the CCL is transformed into either an increase in the SLC or into a draw on the universal service fund, the long distance companies (IXC) will be getting a free ride on the loop.[29] The IXC would be allowed to use a joint and common facility -- the loop – while passing all of the costs through to consumers as fixed per line charges. Eliminating the CCL clearly violates the policy that services included in universal service bear only a reasonable share of joint and common costs. Given the high levels of usage of interLATA long distance service and the demands placed on the network by these services, the CCL is not too high. Indeed, the interLATA use of the loop may already exceed the percentage of loop costs recovered through the CCL.

[28] FCC, Universal Service Order, ¶ 250.

[29] Notice, ¶ 114, pp. 46-47.

III. THE CALLS PROPOSAL RESULTS IN RATES THAT ARE ILLEGAL

A. EMPIRICAL ANALYSIS SHOWS THAT THE CURRENT RECOVERY OF COSTS IN THE FEDERAL JURISDICTION IS EXCESSIVE

1. The Principles Articulated by the FCC have Been Upheld in the Courts and Practical Tools for Implementation are Available

In the three and one-half years since the passage of the Telecommunications Act of 1996 the Commission has articulated a paradigm for the estimation, allocation and recovery of costs that faithfully balances the complex goals of the Act. Through a long series of orders in the universal service, local competition, and access charge reform dockets the Commission's paradigm has identified the following essential principles (in order of their magnitude of importance measured by their impact on rates or the size of the universal service fund):

- ♦ Forward-looking economic costs must be the basis for establishing prices and universal service support.[30]
- ♦ The loop is a shared cost – shared by all of the services that utilize it.[31]
- ♦ Actual competition is the trigger for action, not theory.[32]

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[30] Joint FNPRM

> We agree with the Joint Board that we should use forward-looking costs as a starting point in determining support amounts. We believe that basing support levels on forward-looking costs will send the correct signals for investment, competitive entry and innovation, and that a single national cost model will be the most efficient way to estimate forward-looking cost levels (¶ 11).
>
> We adopt the Joint Board's recommendation that forward-looking economic costs should be used to estimate the costs of providing supported services (¶ 48).

[31] The most explicit statement can be found at Federal Communications Commission, <u>In the Matter of Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Transport Rate Structure and Pricing, End User Common Line Charges: Notice of Proposed</u> Rulemaking, CC Docket Nos. 96-262, 94-1, 91-213, 95-72, ¶ 237

> For example, interstate access is typically provided using the same loops and line cards that are used to provide local service. The costs of these elements are, therefore, common to the provision of both local and long distance service

With the development of the Synthesis Proxy Cost Model (SPCM) and a Supreme Court ruling upholding the concept of forward-looking economic costs, the end is in sight. Now is the time to implement the above principles.

The FCC has received substantial evidence that rates should be declining because productivity has exceeded the rate of inflation by a substantial margin for the past decade. The most extensive studies of local costs commissioned by Public Counsels across the country show even higher productivity increases than the Commission found in the interstate jurisdiction.[33] The Commission should consider reductions in the SLC and the universal service package, rather than rate increases.

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[32] Joint FNPRM.

> Support based on forward-looking models will ensure that support payments remain specific, predictable, and sufficient, as required by section 254, particularly as competition develops. To achieve universal service in a competitive market, support should be based on costs that drive market decisions, and those costs are forward-looking costs. (¶ 50)
>
> The model currently suggests that, using this methodology, a cost benchmark level near the center of the range recommended by the Joint Board would provide support levels that are sufficient to enable reasonably comparable rates, in light of current levels of competition to preserve and advance the Commission's universal service goals. (¶ 99)
>
> We also seek comment on whether we should calculate costs at the study area level. In recommending that the federal support mechanism calculate costs at the study area level, the Joint Board suggested that the level of competition today has not eroded implicit support flows to an extent as to threaten universal service. (¶ 105).

[33] "Rebuttal Testimony of Dr. Marvin Kahn, on Behalf of the Office of the Attorney General," Before the State Corporation Commission of Virginia, In the Matter of Evaluating Investigating the Telephone Regulatory Case No. PUC930036 Methods Pursuant to Virginia Code S. 56-235.5, Cause No. PUC930036, March 15, 1994 and "Prefiled Testimony of David Gable on Behalf of the Indiana Office of Utility Consumer Counselor," Before the Indiana Utility Regulatory Commission, In the Matter of Petition of Indiana Bell Telephone Company, Incorporated for the Commission to Decline to Exercise in Part Its Jurisdiction Over Petitioner's Provision of Basic Local Exchange Service and Carrier Access Service, to Utilize alternative Regulatory Procedures for Petitioner's Provision of Basic Local Exchange Service and Carrier Access Service, and to Decline to Exercise in Whole Its Jurisdiction Over all other Aspects of Petitioner and Its Provision of All Other Telecommunications Service and Equipment, Pursuant to IC 8-1-2.6, Cause Number 39705, January 1994, estimate the productivity offset in the rate of 7 percent per year in the late 1980s and early 1990s.

Now is the time for the subscriber line charge to be eliminated so that the playing field can be leveled for competition. In this way, loop costs would be recovered from two entities, local and long distance companies, who are soon to be competing with one another. Recovering these input costs from suppliers will also place local and long distance companies on an equal footing with other potential providers of loop services. New entrants who provide loop cannot charge consumers a subscriber line charge. Eliminating the subscriber line charge eliminates the wedge between the cost of loop and the costs incurred by the traditional service providers (ILECs and IXCs) who use it.

3. The Failure to Lower the Loop Costs Recovered in the Federal Jurisdiction would be Arbitarty and Capricious

With the legality of forward-looking economic costs as the basis for federal action established and a model for estimating those costs in place, the Commission should move forward by applying that model to all costs in the federal jurisdiction. Indeed, the Commission has already applied this model to loop costs in the high cost proceeding.[34] Although the Commission said in its high cost proceeding that its use of the model there does not require it to apply the model in other proceedings, the CALLS proposal would force the Commission to apply the model in this proceeding.

[34] Large LEC high cost.

The CALLS proposal claims to set switching costs closer to forward-looking economic cost levels.

> To the extent the Commission seeks to set rates based on some measure of cost forward looking cost, itself a matter of debate appropriate cost measures have been particularly difficult to determine. In addition to its origin as a negotiated level, the target rates are within a range of projections that have been suggested as a potential estimate of the economic cost of switched access. Regardless, the targets are clearly closer to forward looking economic costs than current rates.[35]

The level proposed is consistent with the SPCM. To fail to set loop costs at their forward-looking economic levels in this proceeding, when switching costs are being set at that level, would be arbitrary and capricious.

The CALLS proposal makes repeated reference to forward-looking costs and to the various models for estimating those costs.[36] The very same models as described in Exhibit 1, demonstrate that the economic cost of local service is well below claimed embedded costs. The SPCM produces an estimate well within a range of reasonableness. There can be no justification for using the very same models to lower switching costs but not loop costs.

4. Current Cost Recovery In The Federal Jurisdiction Is Excessive

The CALLS proposal is based on an incorrect premise about the subscriber line charge and its relationship to other rates. It assumes, incorrectly, that the current recovery of costs in the federal jurisdiction is inadequate to cover the costs properly assigned to it.

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[35] CALLS, p. 36.

[36] CALLS, pp. 26, 27, 36.

The economic evidence before the Commission shows that the current recovery of costs is excessive. The Commission acknowledges that the Joint Board has not reached a conclusion about the existence of subsidies in the current recovery of common-line revenues.

> The Joint Board, however, made no finding as to whether implicit support exists in interstate access rates, or whether the Commission should make such support explicit if it does exist. (Joint FNPRM, ¶ 42).

We arrive at this empirical result in the following fashion. Exhibit 2 is based on the cost of loop and port as calculated by the SPCM at the wire center level. It shows the cumulative percentage of lines falling below a specific dollar figure.

The statewide average for Texas is $18.22 per month. Since 25 percent of these costs have been allocated to the Federal Jurisdiction, the Federal charges should cover $4.55 per month. Similar estimates for over a dozen states representing almost two-thirds of the lines in the country are presented in Exhibit 3. This analysis shows that Texas is typical of the nation.

Before we estimate how much is collected from residential ratepayers in Texas, there is one observation we would like to make. These data are somewhat old, apparently reflecting 1996 line counts and costs. For example, the data imply that only 4 percent of households have second lines. This would be consistent with 1996 data. By 1997, which is the latest period for which the FCC has data, the percentage on a national basis had increased to about 12 percent.[37] In the 18 months since then, the momentum for second lines has increased. SBC is one of the leaders in selling second lines. For the purpose of this analysis, we use a conservative figure of 20 percent[38]

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[37] Federal Communications Commission, Trends in Telephone Service (February, 1999), table 20.4

[38] *See* Application of Southwestern Bell Telephone Company for Rate Group Reclassification Pursuant to Section 58.058 of the Texas Utility Code, (Jan. 26, 1999), General Counsel Exhibit No. 1 at pg. 23. SWBT indicates that improved marketing of additional [second] phone lines resulted in sales which accounted for approximately 14% of new access

for second lines. This is particularly appropriate since the impact of the FCC decisions that would flow from the instant proceeding will be next year and beyond.[39]

The addition of second lines has a dramatic effect on loop costs. The incremental cost of providing the second line is considerably lower than the first, because most of the capital equipment is deployed. This is especially true of loop and port costs. Consider the following example, which we believe is reasonable. Assume that second line penetration has moved from 4 percent to 20 percent. This assumption is supported by a recent national survey that indicated 24 percent of respondents have a second line.[40] Further assume that the second line costs half as much as the first line. This is a conservative assumption supported by testimony before the FCC and the cost model itself. The statewide average cost for loop and port in Texas would decline from $18.20 to $16.60. In other words the average cost recovery in the federal jurisdiction should be closer to $4.15.

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line in 1993, 18% of new access lines in 1994, 25% of new access lines in 1995, and 29% of new access lines growth in 1996, in Texas. A recent national survey conducted for Joint Consumer Commentors indicates that 24 percent of respondents have more than one line. This is consistent with the assumed 80% primary and 20% non-primary lines.

[39] Trends, Table 20.4, gives year end figures of 114.4 million for residential loops and 17.9 million for additional lines. The figure of 20% for year end 1999 is derived from setting second lines at approximately 25 million and total lines at 123 million. This acceleration of second lines is consistent with the acceleration in Texas as noted in footnote 8.

[40] The October 1999 national survey was conducted by Opinion Research Corporation for Joint Consumer Commentors. The results of this survey are discussed in the Reply Comments, In the Matter of Low-Volume Long-Distance Users, CC Docket No. 99-249 (October 20, 1999).

If the Commission implements its decision to utilize forward-looking economic costs and treat the loop as a common cost, it must conclude that fixed end-user charges (*i.e.*, the subscriber line charge and the PICC) should not be increased but decreased.

- Based upon the results of the default runs of the Synthesis Cost Proxy Model for Texas, we conclude that at least 80 percent of residential lines in Texas are covering 100 percent of the forward looking economic costs of loops and ports (*i.e.*, the non-traffic sensitive portion of costs) that are allocated to the Federal jurisdiction.

Exhibit 4 presents our estimate of the amount collected from residential customers for access in the federal jurisdiction. We assume that 80 percent of the lines in the state are first lines and that 20 percent are additional lines. Based upon the estimates provided by the CALLS, we estimate that in excess of $6.00 per residential account is being collected for access – including the SLC, the PICC and the CCL. In addition, about $2 billion of high cost support is already being recovered in the federal jurisdiction. Since the above analysis looks at average loop costs, that include high cost support, this adds another $.25 to $.50 per month to the overrecovery of costs.[41]

The charges exceed the costs that should be recovered for the vast majority of residential lines in Texas. The federal charges should cover $4.15 to $4.55 per month. However, the federal jurisdiction is collecting over $6.00 per residential account. In other words, based on forward-looking economic costs, the federal jurisdiction is overrecovering $1.50 to $2.00 per month from residential consumers.

[41] The CALLS proposal seeks to "settle" the question of subsidies in other rates at the level of $650 million. This works out to about $.21 per line. In the debate over subsidies, estimates run as high three times that level.

Texas is used as an example because it is a large state that is very close to the national average in forward-looking costs. We reach similar conclusions for other states as well (*see* Exhibit 3). These results show that between three-quarters and nine-tenths of the residential customers already cover the loop costs allocated to the federal jurisdiction. There are a few instances of high-cost states in which a much smaller percentage of the residential customers cover the costs allocated to the federal jurisdiction. That is an issue to be addressed by high cost fund policy.

In summary, over-recovery of costs falls in the range of $1.50 to $2.00 per month per residential line. The total falls in the range of $2.25 to $3 billion annually. Instead of increasing the bottom-of-the-bill charges by almost $2 billion in the residential sector, charges should be decreasing by $2 to $3 billion.

3. The CALLS Proposal Lacks any Empirical Justification for Increasing the Subscriber Line Charge

The closest that the CALLS proposal comes to offering a justification for the increase in the SLC is to point out that increasing the SLC would simply allow it to catch up with inflation.

> Furthermore, the initial proposed SLC cap of $5.50 is the equivalent, in inflation adjusted terms, of a $3.50 SLC in 1984 dollars, the year the SLC was instituted.[42]

While that would be the arithmetic result, there is no underlying economic justification. Telecommunications costs do not track inflation and never have. Technological progress has made the industry a declining cost industry. Over the period since divestiture, the spread of digital

[42] CALLS, p. 17.

line carrier systems, increasing population densities and the growth of second lines have spurred a dramatic decline in costs.

The FCC has erroneously applied all of the increased productivity to the carrier common line component of the federal cost recovery mechanism since it adopted price cap regulation. This has resulted in a dramatic reduction in usage charges (see Exhibit 5). As a result, the compromise that the FCC struck between recovery of federal costs on a fixed and usage basis has been destroyed. In 1984 when the subscriber line charge was instituted, the costs were split on a 50/50 basis. Today, the fixed charges exceed 80 percent of the total.

It is interesting to note that basic local rates, which are largely determined by loop costs, have not tracked inflation since divestiture. Like the subscriber line charge, they have been essentially flat. In other words, state regulators have recognized the declining cost nature of the industry, to a significant degree. In short, there is no economic justification to increase the SLC and there is strong evidence that the recovery of costs in the federal jurisdiction is excessive.

IV. OTHER ELEMENTS OF THE CALLS PROPOSAL RENDER IT ILLEGAL

At least four other elements included in the CALLS proposal would call into question the fairness and reasonableness of the rates it would impose on the public.

A. ABSOLVING CARRIERS OF THEIR OBLIGATION TO MAKE A CONTRIBUTION TO UNIVERSAL SERVICE

1. The 1996 Act Requires Telecommunications Carrier to Contribute to Universal Service

The CALLS proposal would eliminate the clear requirement in the statute that carriers make a contribution to universal service. It shifts the entire cost of universal service onto end users. The federal statute makes no provision for the federal government to recover telecommunications service provider contributions for universal service from ratepayers in the form of a line item surcharge on ratepayers' bills. The federal statute is quite clear that it is telecommunications service providers who must contribute

> **Sec. 254.** (d) Telecommunications Carrier Contribution - Every telecommunications carrier that provides interstate telecommunications services shall contribute, on an equitable and nondiscriminatory basis... .
>
> **Sec. 254.** (f) STATE AUTHORITY - A state may adopt regulations not inconsistent with the Commissions rules to preserve and advance universal service. Every telecommunications carrier that provides intrastate telecommunications services shall contribute.

If subscribers are forced to pay a line item surcharge then telecommunications service providers are not contributing, as required by the Telecommunications Act of 1996. Claims that only a line item on a consumer's bill can meet the requirement that universal service is explicit is a thinly veiled effort to avoid the responsibility the law placed on telecommunications service providers. If a telecommunications service provider is assessed a contribution explicitly to be paid to a universal service fund administrator and pays no other universal service support in any of the prices it is charged, then the funding is explicit. The law does not say funding must be explicit to the customer, it says it must be explicit to the service provider.

As long as all providers are assessed a fair share of the costs of universal service in an explicit rate element, the requirements of the statute will be met. Assessing providers allows them to decide how to recover the universal service costs. Some might pass it through in the form of usage charges. Some might pass it through in the form of customer charges. Still others might not pass it through in an effort to gain market share.

The FCC recognizes this dynamic process in earlier ruling in this proceeding.

> As telecommunications carriers and providers begin merging telecommunications products into single offerings, for example package prices for local and long distance service, we anticipate that they will offer bundled services and new pricing options. Mandating recovery through end-user surcharges would eliminate carrier's pricing flexibility to the detriment of consumers...
>
> In addition, we agree with the state Joint Board members that an end-user surcharge is not necessary to ensure that contributions be explicit. We find that basing contributions on end-user telecommunications revenues satisfies the statutory requirement that support be explicit because carriers will know exactly how much they are contributing to the support mechanism...
>
> As competition intensifies in the markets for local and exchange services in the wake of the 1996 Act, it will likely lessen the ability of carriers and other providers of telecommunications to pass through to customers some or all of the former's contribution to the universal service mechanisms. If contributors, however, choose to pass through part of their contributions and to specify that fact on customer's bills, contributors must be careful to convey information in a manner that does not mislead by omitting important information that indicates that the contributors has chosen to pass through the contribution or part of the contribution to its customers and that accurately describes the nature of the charge.[43]

[43]FCC, Universal Service Order, paras. 853, 854, 855.

1. Claims that the 5th Circuit Ruling Requires a Line Item on End-Users Bills are Incorrect

Some CALLS proponents have asserted that the 5th Circuit decision, Texas Office of Public Utility Counsel v. FCC[44], require that ILEC USF contributions must be recovered through end user surcharges. However, that interpretation of the 5th Circuit decision misstates the Court's holding and fails to reconcile that Court's decision with the decision[45] of the 8th Circuit on the same issue.

First, sec. 254(e) simply states that universal service support "should be explicit." The 5th Circuit panel concluded that the FCC violated that provision because the agency required ILECs to recover the costs of their contributions to the universal service fund through access charges. The panel did not conclude that only an end-user surcharge would satisfy sec. 254(e)'s explicitness requirement, because that issue was not before the Court. Rather, the panel found that the FCC cannot mandate an implicit method of cost recovery.

In fact, the Court is clear that it is focusing on mandatory USF recovery issues when it states, "[b]y forcing GTE to recover its universal service contributions from its access charges, the FCC's interpretation maintains an implicit subsidy for ILEC's such as GTE."[46]

The commenters' argument also fail to harmonize this holding with the 8th Circuit's decision in Southwestern Bell Telephone Co. v. FCC, 153 F.3d 523 (8th Cir. 1998). In that case, on the same issue, the 8th Circuit held that sec. 254(e) did not preclude the FCC from permitting

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[44] Texas Office of Public Utility Counsel v. FCC, 1999 WL 556461 (5th Cir. July 30, 1999).

[45] Southwestern Bell Telephone Co. v. FCC, 153 F.3d 523 (8th Cir. 1998).

[46] *Id.*(emphasis added).

ILECs to recover USF contributions through interstate access charges. The 8th Circuit held:

> We cannot agree that allowing LECs to recoup from their interstate customers the normal costs of providing telecommunications services to those customers amounts to creating a discriminatory implicit subsidy. As the FCC points out, mandatory contributions to the new universal service fund are real costs of doing business that will be incurred by both LECs and IXCs. The agency determined that "[u]nder our recovery mechanism, carriers will be permitted, but not required, to pass through their contributions to their interstate access and interexchange customers." Universal Service Order ¶ 829.
>
> Under this scheme, IXCs have the option of recovering their universal service contributions through rates to their long-distance customers. LECs have the same option of passing on the costs of contributions to their interstate customers--both end users and IXCs. See Order ¶ 379.
>
> Access charges imposed on IXCs that include the LECs' universal service cost are not "above cost" since universal service contributions are a real cost of doing business. The flow-through of LEC universal service costs to its IXC customers is akin to the flow-through of IXC universal service costs to its long-distance customers--neither can be categorized as an implicit subsidy in violation of § 254(e).

Id. at 553-54.

Failing to harmonize both Circuits' decisions misinterprets the current state of the law surrounding sec. 254(e). When both decisions are harmonized it is evident that IXCs and LECs have the discretion to determine whether these costs of doing business are flowed-through to their customers or not. There is no legal requirement that they do so, and certainly no legal requirement that the recovery of the cost should be an end-user surcharge. In any event, 254(e) concerns explicitness of support flowing from the USF and not contributions to the fund.

B. THE CALLS PROPOSAL WOULD UNDERMINE THE COMMISSION'S ABILITY TO ENSURE THAT RATES ARE JUST AND REASONABLE

1. Abandoning the Audit

The CALLS proposal purports to settle the dispute over the audit of LEC accounting records which revealed substantial irregularities. The FCC found that assets that were on the books could not be accounted. These phantom assets are associated with costs that have been imposed on consumers. Yet, the CALLS proposal makes no adjustment in rates to take account of the unjustified charges levied on consumers. There is no reason that consumers should be required to pay for assets that do not exist. Indeed, to the extent that these phantom assets have depressed the apparent overall rate of return of the LECs, consumers have been overcharged.

The Commission cannot simply ignore the audit. To do so would force consumers to pay rates that are not just and reasonable.

2. Abandoning the Productivity Factor

The CALLS proposal eliminates the productivity factor. The productivity factor is the key element in the Price Cap regulatory regime that ensures that rates are just and reasonable. If costs decline as a result of increases in productivity in an environment in which competition is not in effect, and there is no productivity factor to ensure that rates follow costs, excess profits will be earned. Consumers would be charged rates that exceed those which would prevail in a competitive market because neither competition nor regulation will require incumbent LECs with market power to share the fruits of increasing productivity. The practical experience since the creation of the price cap regime is that productivity increases have been substantial. There is every reason to believe they will continue into the future, especially considering the growth of second lines and increasing call volumes. Thus, the failure to include a productivity factor will result in substantial overcharging of consumers.

The market for exchange access has not been found by the Commission to be effectively competitive, nor could it be. Indeed, the Commission has not even found any local market to be irreversibly open. If the Commission eliminates the productivity factor on the mere hope that this market will be competitive at some time in the future, it will be unable to demonstrate that the resulting rates exclude excess profits. Such an action would result in rates that are unjust and unreasonable.

3. Creating an Automatic Mechanism for Increasing Rates

The mistreatment of consumers in the CALLS proposal goes even farther. There would appear to be up escalators, to protect the LECs from inflation, but no down escalators to share in productivity increases. The LECs are allowed to increase rates when costs rise but they are not required to decrease rates when they fall. This scheme is clearly unjust.

V. INCREASING LINE ITEMS UNFAIRLY BURDENS LOW-VOLUME AND LOW-INCOME RESIDENTIAL CONSUMERS

A. PREVIOUS ANALYSES OF THE IMPACT OF RATE RESTRUCTURING ON RESIDENTIAL CONSUMERS

1. Universal Service

In previous comments filed before the Commission in three of the four proceedings identified in the caption for this docket, Joint Consumer Commentors have addressed the distributive impact of proposals to increase line items on consumers' bills. The evidence continues to mount that such a shift is highly regressive, increasing the burden on lower- and middle-income households, while reducing the bills of upper-income households.

In comments filed in the Federal-State Join Board Universal Service proceeding, Texas OPC filed comments urging the FCC to reject the regressive proposal by the industry, *inter alia*, to increase the SLC:

> The proposals by SWB and GTE drive a wedge between the rate reduction for non-core services and the rate increase for core services by adding surcharges directly to customer's bills. Claims that customers will see lower bills or be economically better off are doubtful in light of the surcharges, which would add as much as $5 per month to individual bills.
>
> Even if rates for non-core services are lowered in an amount equal to the aggregate increase in core services, the distribution of the rate increases and decreases will not be even. The explicit purpose of rate rebalancing is to shift costs away from intensive users of the network. It is not surprising to find that lower income groups will receive a disproportionately smaller share of the benefits and pay a disproportionately large share of the costs of rate rebalancing, since the are much less intensive users of the network. Similarly, large business users will receive more benefits than residential ratepayers.[47]
>
> ...
>
> Assuming revenue neutral, across-the-board rebalancing results in net increases in bills for the poorest households and net decreases in bills for the richest. ... The households that suffer the net increase in their bills are the most in need. National numbers indicate that they are likely to be households headed by persons under 25, persons over 65, and females.[48]

[47] Texas OPC, Reply Comments, In the Matter of Federal-State Joint Board on Universal Service, Docket No. 96-45 (May 7, 1996) at pp. 21-22.

[48] Texas OPC, Reply Comments, In the Matter of Federal-State Joint Board on Universal Service, Docket No. 96-45 (May 7, 1996) at pp. 22-23.

In Reply Comments[49] filed over two years ago, Texas OPC analyzed the distributional impact of a proposed $3.33 increase in the subscriber line charge. This is almost exactly what the CALLS proposal suggests. Sprint's data clearly demonstrated that lower-income and low-volume households would bear a disproportionate share of the burden. The evidence presented is consistent with all that has followed. Because it was generated by a company and involves an increase in the SLC close to what is on the table in the CALLS proposal, we quote extensively from that analysis. Everything we have seen leads us to believe it is right on point.

> **'Under Sprint's regressive proposal, low income households will spend a larger percentage of their income to pay for the increase in the SLC, alone, than households with incomes above $75,000 will pay for their entire telephone bill, including the increase in the SLC.**
>
> Sprint offers assurances that price increases for basic service will be offset by price reductions elsewhere, caused by market forces.
>
> However, Sprint's use of qualifiers such as increases "may" be offset, or that the burdens of increases in "many"[50] cases will be offset by price reductions is critical.
>
> Sprint offers no guarantee of any rate reductions. At most, it argues that competition will lower rates for services with higher elasticities of demand.
>
> In its Universal Service comments, Texas OPC challenged these claims. The claim that the long distance market is sufficiently competitive to compel price decreases is arguable at best.
>
> Sprint acknowledges that the local market is not currently sufficiently competitive to be relied upon to impose pricing discipline.

[49] Texas OPC, Reply Comments, In the Matter of Access Charge Reform, Docket No. 96-262, (February 14, 1997).

[50] *See e.g.,* Sprint's quote on page 5 of these comments.

Even for long distance services, the elasticities of demand it cites are by no means high. In fact, the overwhelming majority of non-basic revenues come from services with elasticities of demand that are inelastic (less than one) and therefore not subject to significant downward pressure on pricing.

...

Only if the offset of basic and long distance price changes are equal would residential ratepayers not be harmed. In fact, this is not likely to happen.

Raising basic monthly rates falls most heavily on low volume users, while price reductions are to the benefit of high volume users. If Sprint passes through the rate reductions in proportion to usage, the burden on low volume users outweighs the benefit many times. The most likely losers will be residential consumers and small businesses which make no long distance calls.

To the extent that prices are reduced for residential customers, the reductions are more likely to go to upper income households than low and middle income households. Even if price reductions were passed through evenly, households with incomes above $50,000 would receive approximately 50 percent more than households with incomes below $20,000 and 30 percent more than households with incomes between $20,000 and $50,000.

The previous two analyses can be combined to estimate the incidence of Sprint's proposed $3.33 increase in the SLC on residential ratepayers at various income levels. Assuming a proportionate pass through, approximately 30 percent of the reduction in costs goes to multi-line businesses. The remainder is spread among the income groups in proportion to their consumption of long distance services.
[A]ll groups are worse off, except the highest income group. Very high users in any income group would save, but the vast majority of consumers would be worse off, particularly lower income consumers… For households with incomes below $10,000 for every dollar increase in the SLC, they are likely to have a net increase in their bill of $.50. Up through the middle class, every dollar increase in the SLC is likely to result in net bill increases of $.33. This is truly a case of trickle up economics.

Moreover, given the distribution of revenues, Sprint is unlikely to pass through any cost reductions equally to all customer groups. Sprint is more likely to target its price cuts to its high volume customers. Contrary to Sprint's claims, basic long distance rates have not been tracking access charges. Since 1990, access charges have declined by 15 percent, but interLATA long distance rates are up by 15 percent. The targeting of discounts has resulted in increases in basic long distance rates in the past several years.[51]

[51] Texas OPC, Reply Comments, In the Matter of Federal-State Joint Board on Universal Service, Docket No. 96-45

2. Low-Volume Consumer Bill Analysis

In more recent filings of the Joint Commentors in response to the Notice of Inquiry on Low-Volume Residential Long Distance Users (low-volume proceeding) it has again been demonstrated that increasing line items on the bottom of the bill have a disproportionately negative effect on low-volume households who tend to be lower income households.[52] The evidence presented in that proceeding ends any question about the general impact of these charges.[53] Analysis of actual bills and price indices shows that the increase in fixed charges has resulted in increased phone bills for the majority of residential long distance customers. The FCC's own bill analysis presents stunning testimony to the impact on low volume users (see Exhibit 6). The evidence in the low-volume users proceeding can be summarized as follows:

- Well over half and perhaps as many as two-thirds of all residential customers have experienced an increase because the reduction in per minute charges for usage has not been large enough to offset the increase in bottom of the bill charges.
- Thus, between 50 and 70 million households have been adversely affected.

Much of the debate in the low-volume proceeding turns on whether low-volume consumers can effectively avoid the minimum bill requirements recently imposed by the dominant

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(May 7, 1996) at pp. 10-11, 13-15.

[52] See generally, Joint Comments of CFA, CU and TXOPC (Sept. 21, 1999) and Joint Reply Comments of CFA, CU, and TXOPC (Oct. 20, 1999), In the Matter of Low-Volume Long Distance Users, Docket No. 99-249.

[53] The following Comments, all filed on September 22, 1999, provide the industry's substantive analysis of pricing – *Comments of AT&T* (hereafter AT&T) in particular Exhibit 1, which is *Declaration of Gregory L. Rosston* (hereafter Rosston); *MCI Worldcom, Inc., Comments* (hereafter MCI) and an attached paper by George S. Ford entitled *An Economic Analysis of the FCC's Notice of Inquiry on Flat Rate Changes in the Long Distance Industry* (hereafter Ford), as well as a paper by Robert W. Crandall entitled *Telephone Subsidies, Income Redistribution, and Consumer Welfare* (hereafter Crandall), which was attached to comments of the United States Telephone Association.

firm in the long distance industry. Data presented in a CALLS sponsored study in this proceeding make it absolutely clear that the vast majority of very low-volume customers are not avoiding those charges.[54] We note that the minimum usage requirement is not an issue in the CALLS proceeding, since the purpose of the CALLS proposal is to transform the PICC and USF charges into line items so that all consumers are forced to pay them.

Claims by interexchange companies (IXCs) that long distance rates are "the lowest they have ever been"[55] are true only if the analysis includes business rates and excludes the bottom-of-the-bill charges paid by residential customers. In other words, these claims are false if one looks at the actual bills paid by residential customers, which is the focus of the recent low-volume proceeding.

Low-income consumers are disproportionately low volume consumers. Therefore, low-income, low-volume consumers are hardest hit by these new pricing schemes. Assertions that there is "virtually no correlation between income and low-volume long distance usage"[56] or that the relationship is "very weak"[57] and therefore that the bottom of the bill increase "does not have a material impact on low-income users as a group"[58] are simply wrong. Low-income consumers are much more likely to be low volume consumers and to have suffered a significant increase in

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[54] For example, APT states that 5% of end users do not select a presubscribed interexchange carrier (p. 7)." This means that 5 million accounts have avoided the PICC and minimum bill charges. Our estimate is that 15 million accounts place no interlata, interstate long distance calls in a given month. Another 10 million fall below the level of usage required by the minimum bill requirement.

[55] MCI Comments, In the Matter of Low-Volume Long Distance Users, Docket No. 99-249 (Sept. 21, 1999), p. 3.

[56] *Id*. AT&T Comments, p. 3.

[57] *Id*., MCI Comments, p. 9.

[58] Id., AT&T Comments, p. 3; MCI Comments, p. 10.

their long distance bills.

- About 70 percent of the poorest Americans have suffered a net increase in their bills as a result of recent rate restructuring.
- About 60 percent of the wealthiest Americans have enjoyed a net decrease in their long distance bills.

Thus, the conclusions presented in our low-volume analysis apply directly and with even more force to the analysis of the impact of the CALLS proposal.

B. ANALYSIS OF THE IMPACT OF THE CALLS PROPOSAL

1. APT's Flawed Analysis

The study sponsored by APT and paid for by CALLS that purports to show that consumers are better off as a result of the CALLS rate restructuring proposal is simply wrong because it is based on an assumption about long distance pricing that is contrary to actual practice in the industry. It assumes that long distance companies will pass their reduction in access charges through to usage rates on a uniform basis. All consumers, regardless of their level of usage are projected to receive the same reduction in usage rates.

Ironically, even if one assumes a uniform pass through, *i.e.*, there is no price discrimination, the analysis shows that approximately 85 percent of the so called consumer benefit goes to businesses and wealthy people (see Exhibit 7). The APT analysis concludes that over three-quarters of the benefit would accrue to businesses ($4.1 billion out of $5.3 billion). It should also be stressed that these businesses are not single-line businesses.

APT tries to obscure the fact that upper-income households make many more long distance calls than lower-income households by including local bills in its analysis of the distribution of the impact of the CALLS proposal. The wealthiest one-fifth of the population, roughly equal to those with incomes above $75,000 per year, would capture close to 30 percent of the benefits in the residential sector, or $.35 billion out of APT's projected $1.2 for residential consumers.[59] Thus, $4.45 out of the total $5.3 billion goes to businesses and wealthy households.

2. The Real World Impact

More importantly, there is no reason to assume uniform pass through. That is not the historical practice of the industry that has clearly targeted any such reductions to high-volume users. There is no commitment in the CALLS proposal to pass those reductions through in such a manner. In fact, the CALLS proposal only offers to "discuss with the commission" the matter of the aggregate amount of the pass through.

It is much more reasonable to assume that the half-a-penny reduction in access charges will disappear into the black hole of average revenue per minute calculations the IXCs use to attempt to persuade the FCC into thinking that they have passed through the cost savings. The reality for 70 million consumers with interstate usage below the mean is that, under the CALLS proposal, they will suffer an increase in the bottom-of-the-bill charges of about $1.2 billion. Given historical pricing patterns, they will suffer a net increase in their bills of at least $1 billion (see Exhibit 8).

We arrive at this estimate as follows. The APT study shows that the bottom-of-the-bill charges for primary lines go up about $1.41 per month. We believe that little, if any, of this will

[59] The 1997 PNR data provided by MCI indicates 27 percent, but the income data is not properly reported. The PNR data provided by Crandall indicates over 30 percent.

be offset. Consider what happened in 1998 when the IXC's added about $2 to the bottom of the bills for PICC and USF charges. Assuming that everyone switched to the most attractive discount plan available at their level of usage, average charges went up for households up to about 120 minutes of use.

More importantly, they went up substantially for households with usage below 75 minutes. Exhibit 8 shows that based on that experience, we would expect these consumers to bear virtually the entire burden of the bottom of the bill increase. Even assuming that all of the households on lifeline rates fall into this group, the total would be above $1 billion.

This likely increase in the total bill that would result from the CALLS proposal stands in sharp contrast to what should be happening if the FCC were to implement its forward looking cost analysis. These 70 million households have about 82 million lines.[60] The federal recovery of costs from them should be reduced by between $1.5 to $2 billion.[61]

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[60] The Joint Consumer Commentor national survey indicated that 17 percent of households with usage below the average have more than one line. This is compared to 40 percent of those with usage above the average.

[61] 82 million x $1.5 per month x 12 months = $1.5 billion; 82 million x $2 per month x 12 months = $2 billion .

2. Fixing Problems that Never Should Have Been Created

The CALLS proposal can legitimately claim to solve some problems. Unfortunately, these are very recent problems that have been created by the FCC and the long distance industry and the solution is extremely costly.

For example, the CALLS proposal would exempt consumers receiving Lifeline rates from the PICC (because it would be rolled into the SLC that the FCC waives for these subscribers). Thus, while about 5 million households would not pay the PICC, the remaining 95 million would. The PICC never should have been put on consumers' bills in the first place. In order to save low-income consumers about $100 million per year, the rest of the residential class is stuck with a charge of $1.7 billion. Joint Consumer Commentors are among the strongest supporters of the Lifeline program, but we believe there are better ways to accomplish this goal.

Similarly, the CALLS proposal would eliminate the distinction between first and second lines. That distinction never should have been made. The solution should not be to raise the tax on first lines, it should be to lower it on second lines.

3. The Bottom Line on Bottom-of-the-Bill Charges

The APT methodology is not well described and there are some "adjustments," so the actual impact could be larger. The important point is that if one recognizes the pattern of price discrimination in the industry, one must conclude that the majority of consumers will end up with a higher bill -- and the amount is substantial. Moreover, the bottom-of-the-bill charges mandated by the FCC will grow to alarming levels.

We believe that there will be a charge in the neighborhood of $8 per month per line. This would be composed of over $6 per month for the SLC/PICC and just under $2 per month for universal service.[62] At $8 per month, residential lines generate $12 billion in CCL+USF funds as bottom-of-the-bill charges. This would be an increase of about $5.50 per line or a total of over $8 billion in bottom-of-the-bill charges since the 1996 Act was passed.

C. DEAVERAGING AND DISCRIMINATORY PRICING WILL MAKE MATTERS WORSE, NOT BETTER

The CALLS proposal to deaverage rates is inconsistent with actual market practices and social policy as embodied in the Act of 1996, and is unnecessary if the Commission reforms the SLC in the proper fashion.

The notion that every product is sold at some deaveraged price in the market is simply wrong. Many goods are sold at uniform prices in spite of significant variations in cost. The result is not a subsidy, but a differential mark-up. Any effort by the Commission to deaverage prices will result in massive administrative exercises that companies in competitive markets do not undertake.

Moreover, to the extent that there is a substantial problem of cost difference between areas, there are other policy mechanisms to address this problem. Deaveraging SLC costs would

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[62] In its zeal to make a rigorous comparison of rates with and without the CALLS proposal, the APT analysis appears to have lost track of about a $1per month per account of universal service charges. That is, APT implicitly indicates that USF charges would be $.75 in 2004, when AT&T has already tried to put them at $1.50 and there is at least another $.25 that flows from the CALLS proposal. Compare footnote 7, p. 6 and Figure 1, p. 7, which give the following numbers.

	PRIMARY LINES	
	1999	2004
SLC+ PICC + USF	$5.49	6.90
CALLS SLC + USF	4.52	6.15
IMPLICIT USF	.97	.75

complicate the calculation of necessary subsidies. It would complicate and perhaps violate the Congressional intention to ensure that rates be reasonably comparable between rural and urban areas. It would certainly make it more difficult for long distance companies to maintain geographically averaged rates, as required by section 254 (g) of the Act of 1996.

Joint Consumer Commentors have strenuously rejected the related suggestion that incumbent LECs be allowed to differentially price before all market segments served from common facilities are fully competitive. Incumbents will certainly use their market power to maximize their profit and competitive position. Residential ratepayers who are certain to be the last group offered competitive alternatives will suffer the greatest loss. Moreover, because access is an intermediate good, not an end product, the exercise of market power through differential pricing will significantly hurt competition.

Texas OPC took this view in the Local Competition proceeding in presenting its critique of Ramsey pricing.

> In no event should the Commission adopt Ramsey pricing as a cost allocation scheme. Ramsey pricing has positive welfare properties only under a very stringent set of assumptions. More importantly, the products should be final products not intermediate goods. Because interconnection services and network elements are intermediate goods, Ramsey pricing may well have negative welfare effects. Indeed, given the critical importance of interconnection services and network elements in the competitive strife between new and incumbent LECs, it is likely that a Ramsey pricing (cost allocation) scheme would weight the balance in favor of incumbent LECs, thus hampering rather than furthering the development of local exchange competition.[63]

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[63] OPC Comments, In the Matter of Implementation of Local Competition Provisions in the Telecommunications Act of 1996, Docket No. 96-98 (May 16, 1996) p. 27.

Differential pricing in a market that is subject to inconsistent levels of competition should be rejected.

Ultimately, if the Commission does away with the SLC altogether, and guarantees a pass through to consumers of this immediate benefit, it will not have to deal with the problem of deaveraging the SLC.

Respectfully Submitted,

Texas Office of Public Utility Counsel
Consumer Federation of America
Consumers Union

STATE OF TEXAS §
§
COUNTY OF TRAVIS §

AFFIDAVIT

DECLARATION OF DR. MARK N. COOPER

I, Mark N. Cooper, on my oath do hereby depose, swear and state as follows:

I. BACKGROUND

A. QUALIFICATIONS

1. My name is Mark N. Cooper. I am President of Citizens Research. I am also Director of Research of the Consumer Federation of America (CFA). Prior to founding Citizens Research in 1983, a consulting firm specializing in economic, regulatory and policy analysis, I spent four years as Director of Research at the Consumer Energy Council of America. Prior to that I was an Assistant Professor at Northeastern University teaching courses in Business and Society in the College of Arts and Sciences and the School of Business. I have also been a Lecturer at the Washington College of Law of the American University co-teaching a course in Public Utility Regulation.

2. I have testified on various aspects of telephone and electricity rate making before the public utility commissions of 29 states, the District of Columbia, and Manitoba as well as the Federal Communications Commission (FCC), the Canadian Radio-Television and Telephone Commission (CRTC) and a number of state legislatures.

3. For a decade and a half I have specialized in analyzing regulatory reform and market structure issues in a variety of industries including telecommunications, railroads, airlines, natural gas, electricity, medical services and cable television. This includes approximately 300 pieces of testimony presented to state regulatory bodies, federal legislative bodies, and federal administrative bodies.

4. I have written several major works on universal service and the impact of rising prices for utilities on consumer in general and low income households in particular. These include *Equity and Energy: Rising Energy Prices and the Living Standards of Lower Income Americans* (Westview Press: Boulder, 1982), "protecting the Public Interest in the Transition of Competition

in Network Industries," *The Electric Utility Industry in Transition* (Public Utilities Reports, Inc., 1994); *Universal Service: A Historical Perspective and Policies for the Twenty-First Century* (Benton Foundation and the Consumer Federation of America, 1996).

5. I have participated in each of the dockets cited in the caption to this Notice of Proposed Rulemaking.[64] The notice is in response to a proposal from a coalition (Coalition for Affordable Local and Long Distance Service, "CALLS") made up entirely of telecommunications companies. It would radically alter the Commission's approach to access charges and harm the majority of residential consumers.[65]

6. The purpose of this affidavit is to outline the legal and economic problems underlying the CALLS proposal.

B. THE CALLS PROPOSAL RADICALLY RESTRUCTURES FEDERAL RATES

1. A Sharp Increase in Bottom-of-the-Bill Charges

7. The CALLS proposal would double the cap on the subscriber line charge (SLC) for primary lines. The industry estimates that the net increase in bottom of the bill charges would be about \$1.50 per month. In addition to the net increase, the proposal would shift the Primary Interexchange Carrier Charge (PICC) from the carriers to consumers. It would institutionalize the universal service fund payments as a line item on the bottom of the bill.

8. The proposal would also eliminate the Carrier Common Line Charge (CCL), by using the productivity factor to reduce that charge over time. As soon as the CCL is eliminated, the productivity factor would be eliminated and no further reductions in federal access charges would result from increasing productivity in the industry. The LECs, however, would be able to automatically increase rates to reflect inflation.

9. The proposal would "settle" an audit of the local exchange companies (LECs) which found billions of dollars of irregularities. Unfortunately for consumers, the proposal would not impose any penalties or lower rates to reflect phantom assets that are still embedded in the prices charged to consumers, or even set the rates at lower levels to reflect the overcharges. The CALLS proposal wipes the slate clean.

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[64] Federal Communications Commission, Notice of Proposed Rulemaking, Access Charge Reform, CC Docket No. 96-262, Price Cap Performance Review for local Exchange Carriers, CC Docket No. 94-1, Low Volume Long Distance Users, CC Docket No. 99-249 In the Matter of Federal-State Joint Board on Universal Service:, CC Docket No. 96-45 (September 15, 1999).

[65] *Universal Service and Access Reform Proposal*, Coalition for Affordable Local and Long-Distance Service. For purposes of these comments, we refer to the rate proposal itself and Proposal. We refer to the justification offered as CALLS.

2. The CALLS Proposal will harm the Majority of Residential Consumers

10. CALLS's proponents defend the proposal as "a form of social compact between the regulators and all market participants"[66] that "balances the public interests defined by the 1996 Act."[67] In truth the proposal is much more like the famous Washington D.C. tax game – "don't tax you, don't tax me, tax the guy behind the tree." In this case, the guy behind the tree is the typical American residential consumer whose long distance bill will go up as a result of the proposal when it should be going down.

11. The net effect of the CALLS proposal would be to give the long distance companies a free ride on the distribution plant of the local exchange carriers. The long distance companies would not pay for the facilities (loop plant) they use to provide the services that they sell to the public.

12. The CALLS proposal would increase the bottom-of-the-bill charges paid by residential consumers by about $2 billion and institutionalize another $2 billion in long distance company charges into line items sanctioned by the Federal Communications Commission (FCC or the Commission). If the CALLS proposal is implemented, it would increase Federal bottom-of-the-bill charges paid directly by consumers to local exchange companies to about $12 billion in the residential market alone. This result is tantamount to a federal tax that is largely insulated from competitive pressures. Of this total, over $7 billion will have been added since the passage of the Telecommunications Act of 1996. We do not think this is the balance that Congress had in mind.

13. Studies claiming that all consumers will benefit from the CALLS proposal, such as the study paid for by CALLS but issued under the name of the Alliance for Public Technology (APT),[68] are incorrect because they are based on assumptions that are contradicted by pricing behavior in the industry.[69] The APT study assumes that long distance companies will pass through reductions in costs on a uniform per minute basis. The industry has not done so in the past nor does it commit to do so in the CALLS proposal. <u>The proposal does not even give a guarantee that all of the reductions in access charges will be passed through to consumers, not to mention a commitment to pass them through in a manner that ensures low volume users will receive a fair share of any</u>

[66] CALLS, p. 35.

[67] CALLS, p. 24.

[68] Pociash, Stephen B., *An Assessment of Consumer Welfare Effects of the CALLS Plan* (Joel Popkin and Company, October 25, 1999), p. 1, explains the interrelationship between APT, CALLS and the study.

[69] Joint Consumer Commentors have demonstrated that similarly unrealistic assumptions apply to several other recently released industry studies, particularly those by AT&T; *see* Joint Consumers Reply Comments, Federal Communications Commission, <u>Notice of Inquiry</u>, Low Volume Long Distance Users, CC Docket No. 99-249 (October 20, 1999).

reductions. The CALLS signatories agree only to “commit to meet with the FCC to review the effects.”[70] Simply put, the APT study assumes that there is no price discrimination against low- to average-volume residential long distance consumers, when, in fact, price discrimination has been brutal.

14. Ironically, even if one assumes a uniform pass through, the APT analysis shows that over 85 percent of the so-called consumer benefit goes to businesses and upper income households. Because price discrimination has been rampant in the long distance industry, the actual outcome will be much worse for the majority of consumers.

15. The 70 million residential accounts with usage below the mean are likely to suffer a $1 billion net increase in their long distance bills rather than a decrease because of the industry practice of price discrimination. The FCC’s own Synthesis Proxy Cost Model, which it has recently applied to deliver increased high-cost payments to the large local exchange companies, indicates that these same households should be receiving a net reduction in the federal recovery of costs on the order of $1.5 billion.

16. The recommended increases in the subscriber line charge, the elimination of the PICC and CCL and the increase in, and insitutionalization of the universal service fund as a line item are illegal, arbitrary and capricious, uneconomic and unfair.

Illegal:

- ♦ The uncompensated use of facilities violates section 254 (k) of the Telecommunications Act of 1996 by allowing IXCs to use shared facilities without paying for them. It is contrary to the long standing interpretation of the requirements for reasonable recovery of shared costs which stretches back 70 years to Smith v. Illinois.

- ♦ The CALLS proposal undermines the Commission’s ability to ensure that rates are just and reasonable by “settling” the audit dispute without rate reductions and by eliminating the productivity factors which would force rates to reflect declining costs in the future. At the same time, the proposal includes a mechanism for automatic rate increases.

- ♦ The proposal removes the obligation of telecommunications carriers to contribute to universal service, which contradicts the plain language of the Telecommunications Act of 1996 (the Telecommunications Act or the 1996 Act).

[70] Proposal, section 6.

Arbitrary and capricious:

- The CALLS proposal claims to set switching at forward-looking economic costs. The Commission has recently used forward-looking economic costs to establish the high cost payments for large LECs. Yet, the CALLS proposal does not set recovery of loop costs at forward looking economic levels. In fact, it increases rates well above the forward-looking economic levels, as determined by the very same model used to estimate costs of switching and high-cost loops.

- It is arbitrary and capricious to lower switching costs to reflect forward-looking economic costs but raise loop rates, when the very same model indicates they should be reduced.

Uneconomic:

- The CALLS proposal ignores the integrated nature of modern telecommunications plant and the business plans of telecommunications companies to sell bundled local, long distance, and Internet services.

- The proposal would institutionalize federal charges for access that are far in excess of the economic cost of providing access as estimated by the Commission's own forward-looking cost model and would insulate a huge revenue stream from competitive pressures.

Unfair:

- The proposal shifts the burden of interstate cost recovery onto the shoulders of low-volume users.

- It indemnifies the companies against future inflation by establishing a mechanism to increase rates, while foregoing future productivity offsets, which could lower rates.

- It fails to ensure that bottom-of-the-bill line item increases will be offset in any reasonable way by long distance usage rate reductions.

II. THE ECONOMIC AND LEGAL NATURE OF LOOP COSTS

A. SHARING OF COSTS BETWEEN SERVICES THAT USE JOINT AND

COMMON FACILITIES ACROSS JURISDICTIONS REMAINS SOUND ECONOMIC AND PUBLIC POLICY.

17. Conceptual definitions of costs, analysis of the historic patterns of investment and current, real world activity all indicate that the distribution plant is a shared facility whose costs should be recovered from all services that use it.

18. The loop is a common cost for all telecommunications services that utilize it. In our universal service comments we made the following observations.

19. The Commission has adopted a cost and pricing methodology that recognizes the fundamental economics of the modern telecommunications network. This approach involves (1) the recognition of the telecommunications network as a multi-product undertaking exhibiting strong economies of scale and scope; (2) the treatment of the loop as a common cost; and (3) the comprehension of competitive market behavior. The economic evidence that the telecommunications network is a multi-product enterprise enjoying economies of scale and scope is overwhelming.

- On the supply-side all long distance calls use the network exactly the same way local calls do. Vertical services (like Call Waiting, Call Forwarding and Caller ID) are supported by all parts of the network. Basic service accounts for about one-quarter of total revenues generated per line because the line is shared by an ever-increasing array of services.

- The demands on shared facilities are likely to accelerate as advanced services begin to share in the use of these facilities.

- On the demand-side, customers expect to receive long distance service when they order telephone service. Vertical services are strong complements of basic service. If a provider sells basic service to a customer, competitors are very unlikely to sell that customer Call Waiting.

- ♦ Companies are eager to sell local service and long distance service bundled together.[71] One-stop shopping is an integral part of providers' business plans. In such a bundle, why is local cost the "cost causer", as the LECs and IXCs claim?

20. A reasonable basis to determine the allocation of shared costs is to analyze the facilities and functionalities necessary and actually used in the production of goods and services. In order to produce a long distance call IXCs need distribution plant, as well as switching plant and transport plant. Instead of basing economic analysis on a guess about what consumers really wanted when they purchased a bundle of services, the Commission should rely on a "service pays" principle. That is, services that use facilities should be considered to benefit from the deployment of those facilities and every service that uses a facility should help pay for it.

21. Historical analysis of why telecommunications investments were actually made shows that most telecommunications technologies were deployed for and used by business customers first. Hence, it is more reasonable to assume that those customers caused the investment. History shows that the integration of the long distance network into the local network (they actually started as two separate networks) raised the cost of the integrated network. Since the integrated network costs more as a result of the addition of long distance, it is reasonable to assume that long distance causes costs in the integrated network. In other words, complaints that business customers and long distance users pay too much actually ignore the historic pattern of cost causation.

22. Now that the companies are intensely competing to sell bundles of services, the fiction that local service causes the loop cost should be put to rest once and for all. In truth, since the first decade of this century, the network, including the loop, has been consciously designed to serve local and long distance. Long distance was not an afterthought; it was always a forethought, included in the design, development and deployment of the network. Vertical services have been included in economic analyses of network design and architecture for over a decade.

23. Although historical analysis demonstrates the fallacy of attributing loop costs to only basic local service, it is clear that efforts to unravel the network into cost causation categories are difficult. For that reason, the analysis of costs should be based on the only footing on which sensible economic analysis can be launched -- an assessment of the product, not the psychology of the customer. Regulators should analyze the facilities and functionalities necessary and actually used in the production of goods and services. They should rely on a service pays principle. That is, services that use facilities should be considered to cause the deployment of those facilities. Assumptions about prime movers are arbitrary. There should be no free rides; every service that uses a facility should be required to share in the recovery

[71] Providers are also intensely interested in bundling many more services, such as Internet and data services, in addition to local and long-distance calling.

of the cost of that facility on a reasonable basis.

- As a matter of economics, costs for joint and common facilities should be recovered on the basis of the nature and quality of use that each service makes of those facilities.

- As a matter of public policy from a universal service docket perspective, recovery of joint and common costs should be structured in such a way as to promote universal service by keeping basic service affordable. Adding line items to the bottom of the bill or increasing them makes connectivity to the network more expense and less affordable.

24. Although some theoretical economists chafe at the thought of recovering shared costs across a range of products, common sense and real world experience demonstrates that this is the way markets work. Moreover, the SLC and other fixed charges make no sense in a competitive market when competitors sell bundled local, toll, and long distance service. The fictions that the FCC has established among these "classes" of service will no longer be relevant and will be unable to exist in a competitive market where the line has been blurred between jurisdictional offerings. Competitors will not be selling "local" service or "long distance"; they are and will be selling a bundled package of telephony along with cable, data and Internet services.

B. LEGAL PRINCIPLES

1. Federal and State Law

25. The Telecommunications Act of 1996 certainly understood the economics of the industry and sought efficient entry across a broad range of services.

- The Act promotes the deployment of advanced telecommunications services and information technologies and insists on a sharing of joint and common costs.

- The Act repeatedly recognizes that advanced services and basic service are linked.

- The Act recognizes that competitive and non-competitive services will be commingled on the network and its purpose is to advance this multi-product network.

26. The law directly addresses the revenue responsibility of these various services. The cross-subsidy and joint cost language of 47 USC 254 (k) addresses this point.

> Subsidy of Competitive Service Prohibited – A telecommunications carrier may not use services that are not competitive to subsidize services that are subject to competition. The Commission, with respect to interstate services, and the States, with respect to intrastate services, shall establish any necessary cost allocation rules, accounting safeguards, and guidelines to ensure that services included in the definition of universal service bear no more than a reasonable share of the joint and common costs of facilities used to provide those services.

27. This policy recognizes two distinct steps that are necessary to have fair and efficient pricing in an emerging, partially competitive environment -- a strict prohibition on below cost pricing and a reasonable recovery of joint and common costs across services that share facilities. The Conference Report states this principle more vigorously. The Conference Committee Report clarifies the standard for cost allocation by adopting the Senate report language –

> The Commission and the states are required to establish any necessary cost allocation rules, accounting safeguards, and other guidelines *to ensure that universal service bears no more than a reasonable share (and may bear less than a reasonable share)* of the joint and common facilities used to provide both competitive and noncompetitive services. [72]

28. In pursuit of universal basic service, this language establishes a reasonable share of joint and common costs allocated to basic service as an *upper* limit.

29. The FCC, the states, and the courts have found consistently and repeatedly that the loop is a common cost. The courts recognized this almost three quarters of a century ago in Smith v. Illinois.[73] Many of the states have formally recognized this in comments in federal proceedings,[74] and in their own cost dockets.[75]

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[72] Conference Report, p. 129, *emphasis added*.

[73] 282 U.S. 133 (1930).

[74] Two of the Regional Bell Operating Companies take this point of view (Bell Atlantic and NYNEX), as do a number of state regulators: the Texas Public Utility Commission, the Nebraska Public Service Commission, the New Hampshire Public Utilities Commission, the New Mexico State Corporation Commission, the Utah Public Service Commission, the Vermont Department of Public Service and Public Service Board, and the Public Service Commission of West Virginia. In the Matter of Federal-State Joint Board on Universal Service, Before the Federal Communications Commission, FCC 96-93, CC Docket No. 96-45, April 12, 1996 p. 18; "Comments of the State of Maine Public Utility Commission, the State of Montana Public Service Commission". Virtually all other Consumer Advocate commentors share this view in their initial comments. "Comments of the Idaho Public Service Commission" In the Matter of Federal-State Joint Board on Universal Service, Before the Federal Communications Commission, FCC 96-93, CC Docket No. 96-45, April 12, 1996, p. 17; "Comments of the Public Utility Commission of Texas" In the Matter of Federal-State Joint

30. The failure to take legitimate joint and common costs into account would frustrate the purposes of the 1996 Act. Allowing incumbents to recover joint and common costs excessively from fixed charges on the bottom of the bill discourages efficiency and frustrates competition by allowing incumbents to price more competitive services at an artificially low level. Contrary to the basic premise of the 1996 Act, allowing incumbents to recover an unreasonable share of joint and common costs from basic service insulates incumbents unfairly from market forces.

Board on Universal Service, Before the Federal Communications Commission, FCC 96-93, CC Docket No. 96-45, April 12, 1996, p. ii; "Initial Comments of the Pennsylvania Public Utility Commission to the Notice of Proposed Rulemaking and Order Establishing Joint Board" In the Matter of Federal-State Joint Board on Universal Service, Before the Federal Communications Commission, FCC 96-93, CC Docket No. 96-45, April 12, 1996, p. 7.; Florida, p. 22; "Initial Comments of the Virginia Corporation Commission," In the Matter of Federal-State Joint Board on Universal Service, Before the Federal Communications Commission, FCC 96-93, CC Docket No. 96-45, April 12, 1996, p. 5; "Comments of the Staff of the Indiana Utility Regulatory Commission" In the Matter of Federal-State Joint Board on Universal Service, Before the Federal Communications Commission, FCC 96-93, CC Docket No. 96-45, April 12, 1996, p. 9.

[75] "Report of Glenn P. Richardson, Senior Hearing Examiner, Application of GTE South Incorporated For Revisions to Its Local Exchange, Access and IntraLATA Long Distance Rates, Commonwealth of Virginia State Corporation Commission, Case No. PUVC950019, March 14, 1997, p. 84; Application of the Mountain States Telephone and Telegraph Company dong Business as U.S. West Communications, Inc., for Approval of a Five-Year Plan for Rate and Service Regulation and for a Share Earnings Program, Colorado Public Utilities Commission, Docket Nos. 90a-665T, 96A-281T, 96S-257T, Decision No. C97-88, January 5, 1997, pp. 42-43; Decision and Order Rejecting Tariff Revisions, Washington Utilities and Transportation Commission v. U.S. West Communications Inc., Docket No. UT-950200, April 11, 1996 pp. 83-84; Department of Utility Controls' Investigation Into the Southern New England Telephone Company's Cost of Providing Service, Department of Public Utility Control, Docket No. 94-10-01, June 15, 1995, pp. 24-25; Report and Order, In Re: US West Communications, Inc., Utah Public Service Commission, Docket No. 95-049-05, November 6, 1995, p. 95; Final Decision and Order, In Re US West Communications Inc., Iowa Utilities Board, Docket No. RPU-95-10, May 17, 1996, p. 295, 306; Final Decision and Order, In Re US West Communications Inc., Iowa Utilities Board, Docket No. RPU-94-1, November 21, 1994; In the Matter of the Application of GTE Southwest Incorporates and Contel of the West, Incorporated to Restructure Their Respective Rates, New Mexico State Corporation Commission, Docket NO. 94-291-TC, Phase II, December 27, 1995, pp. 11, 14-15; New England Telephone Generic Rate Structure Investigation, New Hampshire Public Utilities Commission, March 11, 1991, DR 89010, slip, op., pp. 39-40; Order No. 18598, Re: Investigation into Nontraffic-Sensitive Cost Recovery, Florida Public Service Commission, 1987; Docket No. 860984-TP, pp. 258, 265-266; Order No. U-15955, Ex Parte South Central Bell Telephone Company, Docket No. 1-00940035, Louisiana Public Service Commission, September 5, 1995, p. 12; In Re Formal Investigation to Examine and Establish Updated Universal Service Principles and Policies for Telecommunications Services in the Commonwealth, Docket No. 1-00940035, September 5, 1995, p. 12; In the Matter of a Summary Investigation into IntraLATA Toll Access Compensation for Local Exchange Carriers Providing Telephone Services Within the State of Minnesota, Minnesota Public utilities Commission, Docket No. P-999/CI-85-582, November 2, 1987, p. 33.

31. In the residential sector alone, the CALLS proposal would transform over ten billion dollars of the cost of distribution facilities into a bottom-of-the-bill mandated federal payment to local exchange companies. Once these costs appear on the bottom of the bill, they tend to become institutionalized and are much less likely to be competed away. These line items become a floor that the industry starts with, rather than a cost to be attacked by competition.

32. Having concluded that the loop is a shared cost, we turn to the question of how the share of those costs that are allocated to uses that fall within the federal jurisdiction should be recovered. The CCL is a charge to cover the use of a joint and common facility, the loop.

33. If the CCL is transformed into either an increase in the SLC or into a draw on the universal service fund, the long distance companies (IXC) will be getting a free ride on the loop.[76] The IXC would be allowed to use a joint and common facility -- the loop – while passing all of the costs through to consumers as fixed per line charges. Eliminating the CCL clearly violates the policy that services included in universal service bear only a reasonable share of joint and common costs. Given the high levels of usage of interLATA long distance service and the demands placed on the network by these services, the CCL is not too high. Indeed, the interLATA use of the loop may already exceed the percentage of loop costs recovered through the CCL.

III. THE CALLS PROPOSAL RESULTS IN RATES THAT ARE ILLEGAL

B. EMPIRICAL ANALYSIS SHOWS THAT THE CURRENT RECOVERY OF COSTS IN THE FEDERAL JURISDICTION IS EXCESSIVE

1. The Principles Articulated by the FCC have Been Upheld in the Courts and Practical Tools for Implementation are Available

34. In the three and one-half years since the passage of the Telecommunications Act of 1996 the Commission has articulated a paradigm for the estimation, allocation and recovery of costs that faithfully balances the complex goals of the Act. Through a long series of orders in the universal service, local competition, and access charge reform dockets the Commission's paradigm has identified the following essential principles (in order of their magnitude of importance measured by their impact on rates or the size of the universal service fund):

[76] Notice, ¶ 114, pp. 46-47.

- ♦ Forward-looking economic costs must be the basis for establishing prices and universal service support.[77]

- ♦ The loop is a shared cost – shared by all of the services that utilize it.[78]

- ♦ Actual competition is the trigger for action, not theory.[79]

35. With the development of the Synthesis Proxy Cost Model (SPCM) and a Supreme Court ruling upholding the concept of forward-looking economic costs, the end is in sight. Now is the time to implement the above principles.

36. The FCC has received substantial evidence that rates should be declining because productivity

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[77] Joint FNPRM

> We agree with the Joint Board that we should use forward-looking costs as a starting point in determining support amounts. We believe that basing support levels on forward-looking costs will send the correct signals for investment, competitive entry and innovation, and that a single national cost model will be the most efficient way to estimate forward-looking cost levels (¶ 11).
>
> We adopt the Joint Board's recommendation that forward-looking economic costs should be used to estimate the costs of providing supported services (¶ 48).

[78] The most explicit statement can be found at Federal Communications Commission, In the Matter of Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Transport Rate Structure and Pricing, End User Common Line Charges: Notice of Proposed Rulemaking, CC Docket Nos. 96-262, 94-1, 91-213, 95-72, ¶ 237

> For example, interstate access is typically provided using the same loops and line cards that are used to provide local service. The costs of these elements are, therefore, common to the provision of both local and long distance service

[79] Joint FNPRM.

> Support based on forward-looking models will ensure that support payments remain specific, predictable, and sufficient, as required by section 254, particularly as competition develops. To achieve universal service in a competitive market, support should be based on costs that drive market decisions, and those costs are forward-looking costs. (¶ 50)
>
> The model currently suggests that, using this methodology, a cost benchmark level near the center of the range recommended by the Joint Board would provide support levels that are sufficient to enable reasonably comparable rates, in light of current levels of competition to preserve and advance the Commission's universal service goals. (¶ 99)
>
> We also seek comment on whether we should calculate costs at the study area level. In recommending that the federal support mechanism calculate costs at the study area level, the Joint Board suggested that the level of competition today has not eroded implicit support flows to an extent as to threaten universal service. (¶ 105).

has exceeded the rate of inflation by a substantial margin for the past decade. The most extensive studies of local costs commissioned by Public Counsels across the country show even higher productivity increases than the Commission found in the interstate jurisdiction.[80] The Commission should consider reductions in the SLC and the universal service package, rather than rate increases.

37. Now is the time for the subscriber line charge to be eliminated so that the playing field can be leveled for competition. In this way, loop costs would be recovered from two entities, local and long distance companies, who are soon to be competing with one another. Recovering these input costs from suppliers will also place local and long distance companies on an equal footing with other potential providers of loop services. New entrants who provide loop cannot charge consumers a subscriber line charge. Eliminating the subscriber line charge eliminates the wedge between the cost of loop and the costs incurred by the traditional service providers (ILECs and IXCs) who use it.

2. The Failure to Lower the Loop Costs Recovered in the Federal Jurisdiction would be Arbitarty and Capricious

38. With the legality of forward-looking economic costs as the basis for federal action established and a model for estimating those costs in place, the Commission should move forward by applying that model to all costs in the federal jurisdiction. Indeed, the Commission has already applied this model to loop costs in the high cost proceeding.[81] Although the Commission said in its high cost proceeding that its use of the model there does not require it to apply the model in other proceedings, the CALLS proposal would force the Commission to apply the model in this proceeding.

[80] "Rebuttal Testimony of Dr. Marvin Kahn, on Behalf of the Office of the Attorney General," Before the State Corporation Commission of Virginia, In the Matter of Evaluating Investigating the Telephone Regulatory Case No. PUC930036 Methods Pursuant to Virginia Code S. 56-235.5, Cause No. PUC930036, March 15, 1994 and "Prefiled Testimony of David Gable on Behalf of the Indiana Office of Utility Consumer Counselor," Before the Indiana Utility Regulatory Commission, In the Matter of Petition of Indiana Bell Telephone Company, Incorporated for the Commission to Decline to Exercise in Part Its Jurisdiction Over Petitioner's Provision of Basic Local Exchange Service and Carrier Access Service, to Utilize alternative Regulatory Procedures for Petitioner's Provision of Basic Local Exchange Service and Carrier Access Service, and to Decline to Exercise in Whole Its Jurisdiction Over all other Aspects of Petitioner and Its Provision of All Other Telecommunications Service and Equipment, Pursuant to IC 8-1-2.6, Cause Number 39705, January 1994, estimate the productivity offset in the rate of 7 percent per year in the late 1980s and early 1990s.

[81] Large LEC high cost.

39. The CALLS proposal claims to set switching costs closer to forward-looking economic cost levels.

> To the extent the Commission seeks to set rates based on some measure of cost forward looking cost, itself a matter of debate appropriate cost measures have been particularly difficult to determine. In addition to its origin as a negotiated level, the target rates are within a range of projections that have been suggested as a potential estimate of the economic cost of switched access. Regardless, the targets are clearly closer to forward looking economic costs than current rates.[82]

40. The level proposed is consistent with the SPCM. To fail to set loop costs at their forward-looking economic levels in this proceeding, when switching costs are being set at that level, would be arbitrary and capricious.

41. The CALLS proposal makes repeated reference to forward-looking costs and to the various models for estimating those costs.[83] The very same models as described in Exhibit 1, demonstrate that the economic cost of local service is well below claimed embedded costs. The SPCM produces an estimate well within a range of reasonableness. There can be no justification for using the very same models to lower switching costs but not loop costs.

3. Current Cost Recovery In The Federal Jurisdiction Is Excessive

42. The CALLS proposal is based on an incorrect premise about the subscriber line charge and its relationship to other rates. It assumes, incorrectly, that the current recovery of costs in the federal jurisdiction is inadequate to cover the costs properly assigned to it.

43. The economic evidence before the Commission shows that the current recovery of costs is excessive (see Exhibit 1). I arrive at this empirical result in the following fashion. Exhibit 2 is based on the cost of loop and port as calculated by the SPCM at the wire center level. It shows the cumulative percentage of lines falling below a specific dollar figure.

44. The statewide average for Texas is $18.22 per month. Since 25 percent of these costs have been allocated to the Federal Jurisdiction, the Federal charges should cover $4.55 per month. Similar estimates for over a dozen states representing almost two-thirds of the lines in the country are presented in Exhibit 3. This analysis shows that Texas is typical of the nation.

[82] CALLS, p. 36.

[83] CALLS, pp. 26, 27, 36.

45. Before we estimate how much is collected from residential ratepayers in Texas, there is one observation we would like to make. These data are somewhat old, apparently reflecting 1996 line counts and costs. For example, the data imply that only 4 percent of households have second lines. This would be consistent with 1996 data. By 1997, which is the latest period for which the FCC has data, the percentage on a national basis had increased to about 12 percent.[84] In the 18 months since then, the momentum for second lines has increased. SBC is one of the leaders in selling second lines. For the purpose of this analysis, we use a conservative figure of 20 percent[85] for second lines. This is particularly appropriate since the impact of the FCC decisions that would flow from the instant proceeding will be next year and beyond.[86]

46. The addition of second lines has a dramatic effect on loop costs. The incremental cost of providing the second line is considerably lower than the first, because most of the capital equipment is deployed. This is especially true of loop and port costs. Consider the following example, which we believe is reasonable. Assume that second line penetration has moved from 4 percent to 20 percent. This assumption is supported by a recent national survey that indicated 24 percent of respondents have a second line.[87] Further assume that the second line costs half as much as the first line. This is a conservative assumption supported by testimony before the FCC and the cost model itself. The statewide average cost for loop and port in Texas would decline from $18.20 to $16.60. In other words the average cost recovery in the federal jurisdiction should be closer to $4.15.

47. If the Commission implements its decision to utilize forward-looking economic costs and treat the loop as a common cost, it must conclude that fixed end-user charges (*i.e.*, the subscriber line charge and the PICC) should not be increased but decreased.

- Based upon the results of the default runs of the Synthesis Cost Proxy Model for Texas, we conclude that at least 80 percent of residential lines in Texas are covering

[84] Federal Communications Commission, Trends in Telephone Service (February, 1999), table 20.4

[85] *See* Application of Southwestern Bell Telephone Company for Rate Group Reclassification Pursuant to Section 58.058 of the Texas Utility Code, (Jan. 26, 1999), General Counsel Exhibit No. 1 at pg. 23. SWBT indicates that improved marketing of additional [second] phone lines resulted in sales which accounted for approximately 14% of new access line in 1993, 18% of new access lines in 1994, 25% of new access lines in 1995, and 29% of new access lines growth in 1996, in Texas. A recent national survey conducted for Joint Consumer Commentors indicates that 24 percent of respondents have more than one line. This is consistent with the assumed 80% primary and 20% non-primary lines.

[86] Trends, Table 20.4, gives year end figures of 114.4 million for residential loops and 17.9 million for additional lines. The figure of 20% for year end 1999 is derived from setting second lines at approximately 25 million and total lines at 123 million. This acceleration of second lines is consistent with the acceleration in Texas as noted in footnote 8.

[87] The October 1999 national survey was conducted by Opinion Research Corporation for Joint Consumer Commentors. The results of this survey are discussed in the Reply Comments, In the Matter of Low-Volume Long-Distance Users, CC Docket No. 99-249 (October 20, 1999).

100 percent of the forward looking economic costs of loops and ports (*i.e.*, the non-traffic sensitive portion of costs) that are allocated to the Federal jurisdiction.

48. Exhibit 4 presents our estimate of the amount collected from residential customers for access in the federal jurisdiction. We assume that 80 percent of the lines in the state are first lines and that 20 percent are additional lines. Based upon the estimates provided by the CALLS, we estimate that in excess of $6.00 per residential account is being collected for access – including the SLC, the PICC and the CCL. In addition, about $2 billion of high cost support is already being recovered in the federal jurisdiction. Since the above analysis looks at average loop costs, that include high cost support, this adds another $.25 to $.50 per month to the overrecovery of costs.[88]

49. The charges exceed the costs that should be recovered for the vast majority of residential lines in Texas. The federal charges should cover $4.15 to $4.55 per month. However, the federal jurisdiction is collecting over $6.00 per residential account. In other words, based on forward-looking economic costs, the federal jurisdiction is overrecovering $1.50 to $2.00 per month from residential consumers.

50. Texas is used as an example because it is a large state that is very close to the national average in forward-looking costs. We reach similar conclusions for other states as well (*see* Exhibit 3). These results show that between three-quarters and nine-tenths of the residential customers already cover the loop costs allocated to the federal jurisdiction. There are a few instances of high-cost states in which a much smaller percentage of the residential customers cover the costs allocated to the federal jurisdiction. That is an issue to be addressed by high cost fund policy.

51. In summary, over-recovery of costs falls in the range of $1.50 to $2.00 per month per residential line. The total falls in the range of $2.25 to $3 billion annually. Instead of increasing the bottom-of-the-bill charges by almost $2 billion in the residential sector, charges should be decreasing by $2 to $3 billion.

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[88] The CALLS proposal seeks to "settle" the question of subsidies in other rates at the level of $650 million. This works out to about $.21 per line. In the debate over subsidies, estimates run as high three times that level.

52. The closest that the CALLS proposal comes to offering a justification for the increase in the SLC is to point out that increasing the SLC would simply allow it to catch up with inflation.

> Furthermore, the initial proposed SLC cap of $5.50 is the equivalent, in inflation adjusted terms, of a $3.50 SLC in 1984 dollars, the year the SLC was instituted.[89]

53. While that would be the arithmetic result, there is no underlying economic justification. Telecommunications costs do not track inflation and never have. Technological progress has made the industry a declining cost industry. Over the period since divestiture, the spread of digital line carrier systems, increasing population densities and the growth of second lines have spurred a dramatic decline in costs.

54. The FCC has erroneously applied all of the increased productivity to the carrier common line component of the federal cost recovery mechanism since it adopted price cap regulation. This has resulted in a dramatic reduction in usage charges (see Exhibit 5). As a result, the compromise that the FCC struck between recovery of federal costs on a fixed and usage basis has been destroyed. In 1984 when the subscriber line charge was instituted, the costs were split on a 50/50 basis. Today, the fixed charges exceed 80 percent of the total.

55. It is interesting to note that basic local rates, which are largely determined by loop costs, have not tracked inflation since divestiture. Like the subscriber line charge, they have been essentially flat. In other words, state regulators have recognized the declining cost nature of the industry, to a significant degree. In short, there is no economic justification to increase the SLC and there is strong evidence that the recovery of costs in the federal jurisdiction is excessive.

IV. OTHER ELEMENTS OF THE CALLS PROPOSAL RENDER IT ILLEGAL

56. At least four other elements included in the CALLS proposal would call into question the fairness and reasonableness of the rates it would impose on the public.

57. The CALLS proposal would eliminate the clear requirement in the statute that carriers make a contribution to universal service. It shifts the entire cost of universal service onto end users. The federal statute makes no provision for the federal government to recover telecommunications service provider contributions for universal service from ratepayers in the form of a line item surcharge on ratepayers' bills. The federal statute is quite clear that it is telecommunications service providers who must contribute

> **Sec. 254.** (d) Telecommunications Carrier Contribution - Every

[89] CALLS, p. 17.

> telecommunications carrier that provides interstate telecommunications services shall contribute, on an equitable and nondiscriminatory basis... .
>
> **Sec. 254.** (f) STATE AUTHORITY - A state may adopt regulations not inconsistent with the Commissions rules to preserve and advance universal service. Every telecommunications carrier that provides intrastate telecommunications services shall contribute.

58. If subscribers are forced to pay a line item surcharge then telecommunications service providers are not contributing, as required by the Telecommunications Act of 1996. Claims that only a line item on a consumer's bill can meet the requirement that universal service is explicit is a thinly veiled effort to avoid the responsibility the law placed on telecommunications service providers. If a telecommunications service provider is assessed a contribution explicitly to be paid to a universal service fund administrator and pays no other universal service support in any of the prices it is charged, then the funding is explicit. The law does not say funding must be explicit to the customer, it says it must be explicit to the service provider.

59. As long as all providers are assessed a fair share of the costs of universal service in an explicit rate element, the requirements of the statute will be met. Assessing providers allows them to decide how to recover the universal service costs. Some might pass it through in the form of usage charges. Some might pass it through in the form of customer charges. Still others might not pass it through in an effort to gain market share.

60. The CALLS proposal purports to settle the dispute over the audit of LEC accounting records which revealed substantial irregularities. The FCC found that assets that were on the books could not be accounted. These phantom assets are associated with costs that have been imposed on consumers. Yet, the CALLS proposal make no adjustment in rates to take account of the unjustified charges levied on consumers. There is no reason that consumers should be required to pay for assets that do not exist. Indeed, to the extent that these phantom assets have depressed the apparent overall rate of return of the LECs, consumers have been overcharged.

61. The Commission cannot simply ignore the audit. To do so would force consumers to pay rates that are not just and reasonable.

62. The CALLS proposal eliminates the productivity factor. The productivity factor is the key element in the Price Cap regulatory regime that ensures that rates are just and reasonable. If costs decline as a result of increases in productivity in an environment in which competition is not effect, and there is no productivity factor to ensure that rates follow costs, excess profits will be earned. Consumers would be charged rates that exceed those which would prevail in a competitive market because neither competition nor regulation will require incumbent LECs with market power to share the fruits of increasing productivity. The practical experience since the creation of the price cap regime is that productivity increases have been substantial. There is every reason to believe they will continue into the future, with the growth of second lines and increasing call volumes. Thus, the failure to include a productivity factor will result in substantial overcharging of consumers.

63. The market for exchange access has not been found by the Commission to be effectively competitive, nor could it be. Indeed, the Commission has not even found any local market to be irreversibly open. The Commission cannot eliminate the productivity factor on the hope that this market will be competitive at some time in the future and demonstrate that the resulting rates would not result in prices that include excess profits and, therefore, are unjust and unreasonable.

64. The mistreatment of consumers in the CALLS proposal goes even farther. There would appear to be up escalators, to protect the LECs from inflation, but no down escalators to share in productivity increases. The LECs are allowed to increase rates when costs rise but they are not required to decrease rates when they fall. This scheme is clearly unjust.

Further, the affiant sayeth not.

________/s/______________

Mark. N. Cooper

SUBSCRIBED and sworn to before me this 11th day of November, 1999

____

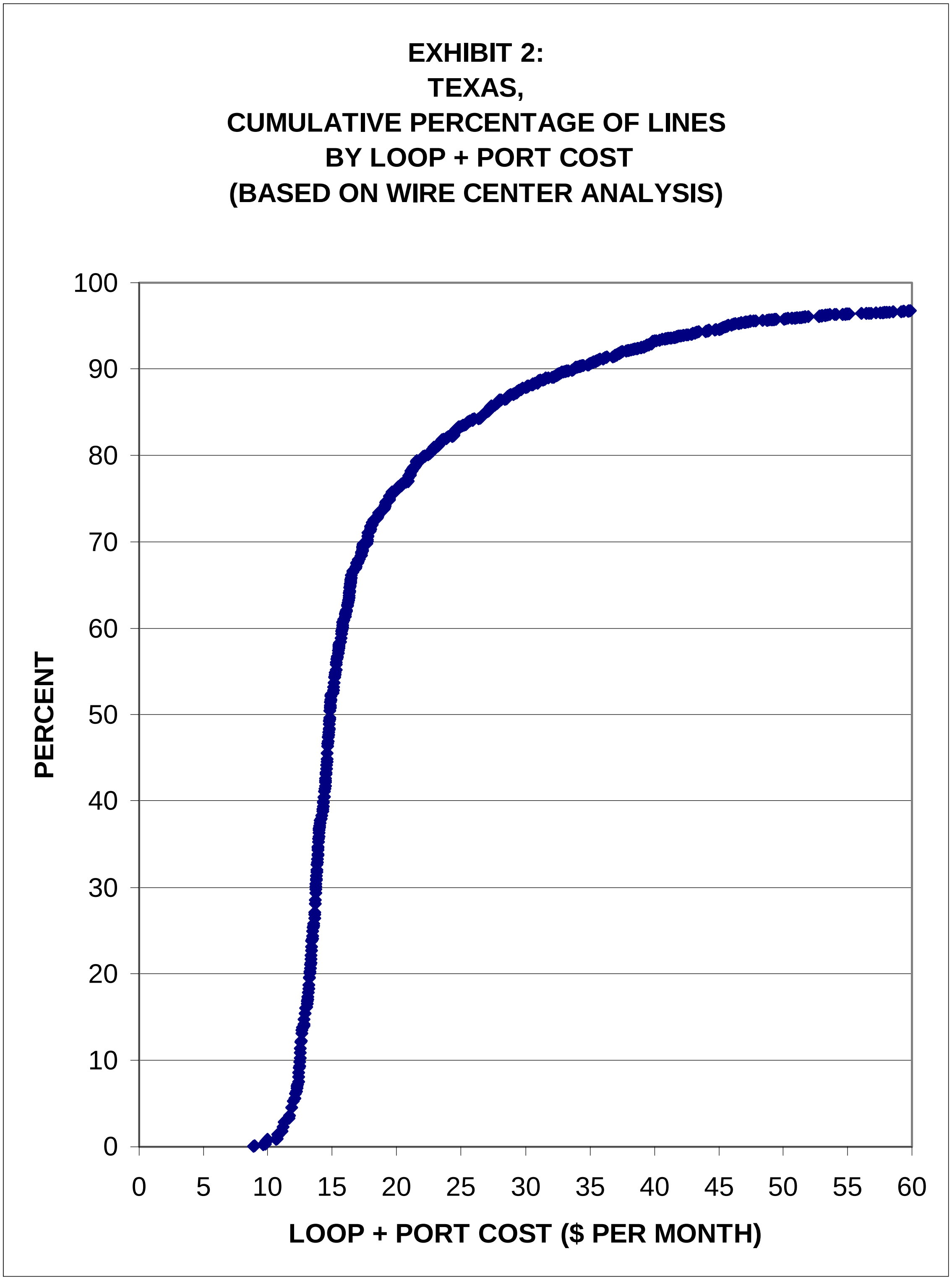
Notary Public, State of Texas

Exhibits

EXHIBIT 1
ESTIMATION OF OVERRECOVERY OF COSTS FOR LOOP AND PORT: EMBEDDED COSTS COMPARED TO FORWARD LOOKING COSTS

	COST ESTIMATES								EFFICIENCY GAINS				
STATE	EMBED	FCC		BCM		FCC		HTFLD	"1995"		"1998"		FCC
		BCPM	HAT	ARMIS	HTFLD	SPCM		"5.0"	LOW	HIGH	LOW	HIGH	SPCM
AL	36.38	30.98	29.31	26.46	19.19	28.86		26.06	9.92	17.19	5.40	10.32	7.52
AR	43.48	34.48	28.08	33.56	24.34	26.95		24.93	9.92	19.14	9.00	18.55	16.53
AZ	31.18	27.49	21.33	21.26	15.41	17.94		17.22	9.92	15.77	3.69	13.96	13.24
CA	27.97	20.26	18.18	18.05	13.09	15.60		13.65	9.92	14.88	7.71	14.32	12.37
CO	35.72	27.82	24.33	25.80	18.71	20.40		19.93	9.92	17.01	7.90	15.79	15.32
DC	21.11	16.62	13.35	11.19	8.11	11.65		11.77	9.92	13.00	4.49	9.34	9.46
DE	31.85	24.61	21.37	21.93	15.90	18.96		17.92	9.92	15.95	7.24	13.93	12.89
FL	30.32	23.60	19.09	20.40	14.79	17.12		15.34	9.92	15.53	6.72	14.98	13.20
GA	37.41	26.83	23.24	27.49	19.93	21.36		19.94	9.92	17.48	10.58	17.47	16.05
IA	41.50	29.31	23.37	31.58	22.90	21.04		18.72	9.92	18.60	12.19	22.78	20.46
ID	50.86	32.68	27.60	40.94	29.69	25.25		22.38	9.92	21.17	18.18	28.48	25.61
IL	30.65	22.44	19.58	20.73	15.03	15.67		14.85	9.92	15.62	8.21	15.80	14.98
IN	30.50	25.88	20.65	20.58	14.93	20.53		17.76	9.92	15.57	4.62	12.74	9.97
KS	42.93	31.28	25.38	33.01	23.94	22.86		22.58	9.92	18.99	11.65	20.35	20.07
KY	35.37	31.25	29.73	25.45	18.46	29.45		24.12	9.92	16.91	4.12	11.25	5.92
LA	36.37	29.12	25.68	26.45	19.18	24.11		21.94	9.92	17.19	7.25	14.43	12.26
MA	23.04	22.09	20.01	13.12	9.52	16.23		15.82	9.92	13.52	0.95	7.22	6.81
MD	28.48	23.35	21.08	18.56	13.46	17.88		17.29	9.92	15.02	5.13	11.19	10.60
ME	44.16	32.06	31.36	34.24	24.83	29.40		27.66	9.92	19.33	12.10	16.50	14.76
MI	32.87	25.09	20.69	22.95	16.64	19.10		16.86	9.92	16.23	7.78	16.01	13.77
MN	39.36	26.23	22.99	29.46	21.36	20.53		20.13	9.90	18.00	13.13	19.23	18.83
MO	38.35	27.07	23.56	28.43	20.61	21.38		20.39	9.92	17.74	11.28	17.96	16.97
MS	41.96	39.10	38.61	32.04	23.24	38.34		34.22	9.92	18.72	2.86	7.74	3.62
MT	64.50	42.39	32.29	54.58	39.58	29.95		26.55	9.92	24.92	22.11	37.95	34.55
NC	37.24	26.84	23.28	27.32	19.81	21.47		20.53	9.92	17.43	10.40	16.71	15.77
ND	60.52	35.79	28.92	50.60	36.69	24.37		25.07	9.92	23.83	24.73	35.45	36.15
NE	46.45	31.18	31.39	36.53	26.49	25.19		29.69	9.92	19.96	15.27	16.76	21.26
NH	38.23	28.08	26.41	28.31	20.53	23.61		22.74	9.92	17.70	10.15	15.49	14.62
NJ	26.78	20.14	18.36	16.86	12.23	14.99		13.88	9.92	14.55	6.64	12.90	11.79
NM	44.59	31.85	27.40	34.67	25.14	23.55		22.82	9.92	19.45	12.74	21.77	21.04
NV	39.09	32.48	31.81	29.17	21.15	23.74		26.48	9.92	17.94	6.61	12.61	15.35
NY	26.50	21.74	19.64	16.58	12.02	16.03		11.69	9.92	14.48	4.76	14.81	10.47
OH	31.32	24.03	19.41	21.40	15.20	17.58		15.90	9.92	16.12	7.29	15.42	13.74
OK	36.51	31.41	27.90	26.59	19.28	24.69		24.46	9.92	17.23	5.10	12.05	11.82
OR	37.91	27.35	23.94	27.99	20.29	19.87		19.27	9.92	17.62	10.56	18.64	18.04
PA	30.16	23.57	21.16	20.24	14.67	17.61		16.86	9.92	15.49	6.59	13.30	12.55
RI	27.59	24.12	20.25	17.67	12.82	17.22		15.75	9.92	14.77	3.47	11.84	10.37

SC	38.47	29.31	25.54	28.55	20.70	24.66		22.09	9.92	17.77	9.16	16.38	13.81
SD	60.94	38.97	32.06	51.52	37.00	27.30		27.39	9.42	23.94	21.97	33.55	33.64
TN	37.19	38.80	26.34	27.27	19.77	24.96		22.48	9.92	17.42	-1.61	14.71	12.23
TX	35.06	26.15	21.39	25.14	18.23	19.07		17.78	9.92	16.83	8.91	17.28	15.99
UT	37.93	25.72	22.04	28.01	20.31	18.55		17.68	9.92	17.62	12.21	20.25	19.38
VA	29.77	24.98	21.74	19.85	14.39	19.17		18.64	9.92	15.38	4.79	11.13	10.60
VT	45.94	33.91	33.34	36.02	26.12	31.47		29.62	9.92	19.82	12.03	16.32	14.47
WA	33.40	25.32	21.35	24.48	17.02	18.33		17.15	8.92	16.38	8.08	16.25	15.07
WI	37.10	24.29	19.05	27.18	19.71	18.75		15.50	9.92	17.39	12.81	21.60	18.35
WV	41.36	36.39	32.51	31.44	22.80	34.03		33.23	9.92	18.56	4.97	8.13	7.33
WY	58.06	45.87	39.30	48.14	34.91	33.55		33.41	9.92	23.15	12.19	24.65	24.51
AVG.	32.71	25.37	21.89	22.81	16.51	19.27		17.66	9.90	16.19	7.34	15.05	13.44



Source: FCC, SPCM.

EXHIBIT 3

ESTIMATES OF COST AND COST RECOVERY

STATE	FORWARD LOOKING LOOP + PORT COST (STATE AVERAGE)	PERCENT OF LOOPS COVERING FEDERAL COSTS AT $5.50
TX	$18.22	81%
CA	14.84	94
NY	14.92	91
UT	16.83	90
IL	17.28	87
AZ	15.67	92
MD	16.55	86
FLA	16.67	91
PA	17.17	80
CO	17.70	84
WA	17.89	88
GA	19.99	77
MI	20.16	75
KS	19.82	76
IN	22.55	72
ID	24.17	65
MO	24.32	71
AR	25.93	58
WY	31.03	41

SOURCE: Federal Communication s Commission, *Synthesis Proxy Cost Model*

EXHIBIT 4

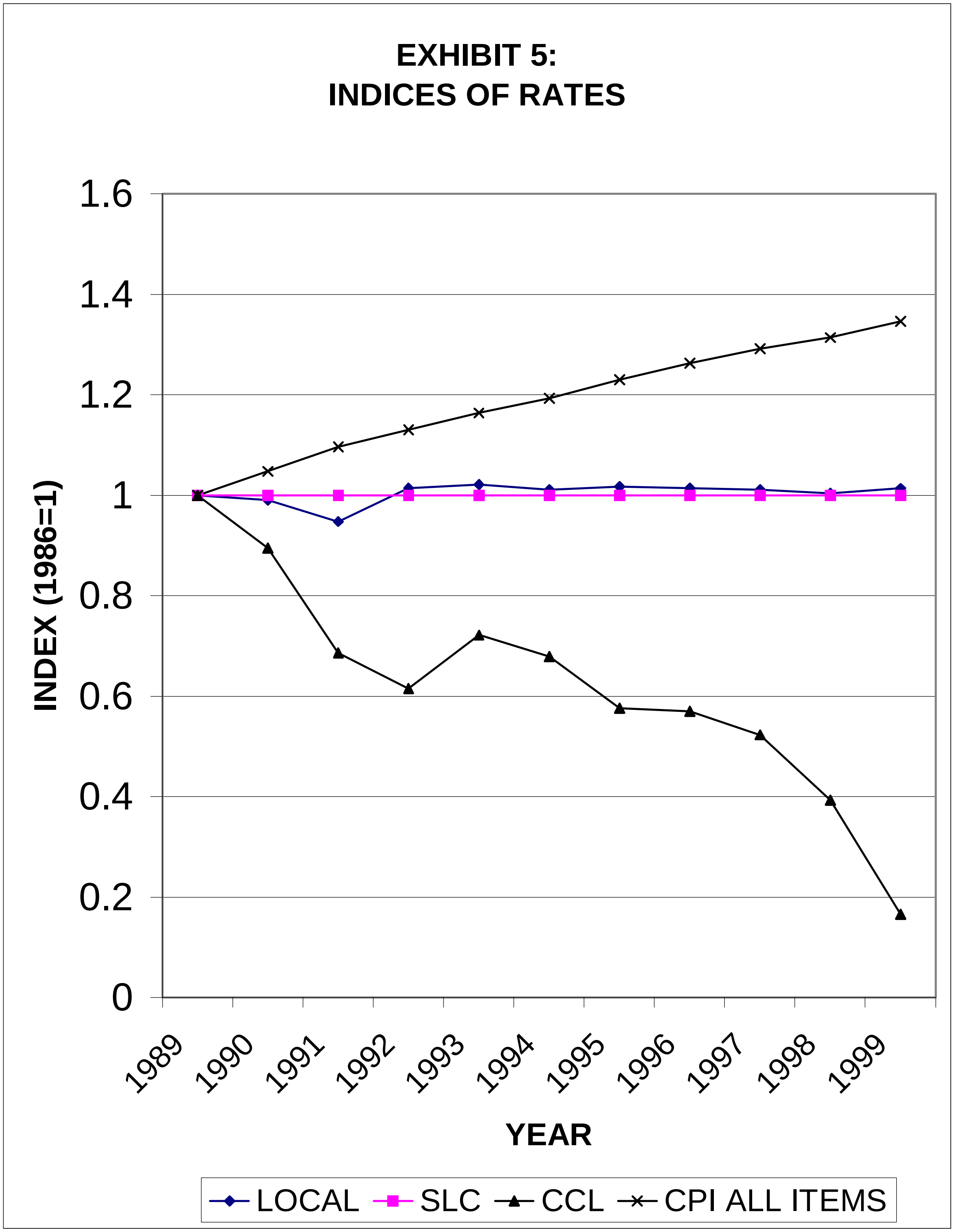
ESTIMATED ACCESS COST RECOVERY FOR THE
TEXAS RESIDENTIAL MARKET PROJECTED FOR 2000

	(1) PROPORTION OF LINES	(2) UNIT COST PER LINE	(3=1x2) WEIGTHED COST
SUBSCRIBER LINE CHARGE			
	(a)	(b)	
First Line	1.0	$3.50	$3.50
Second Line	.24	6.07	<u>1.47</u>
Average Per line	1.0		$4.97
PICC			
Average Per Line			$.75
FIXED CHARGES PER LINE			$5.72
USAGE CHARGES			
CCL (100 Minutes @.002/Minute)			.20
Other "subsidies"			<u>.21</u>
TOTAL			$6.13

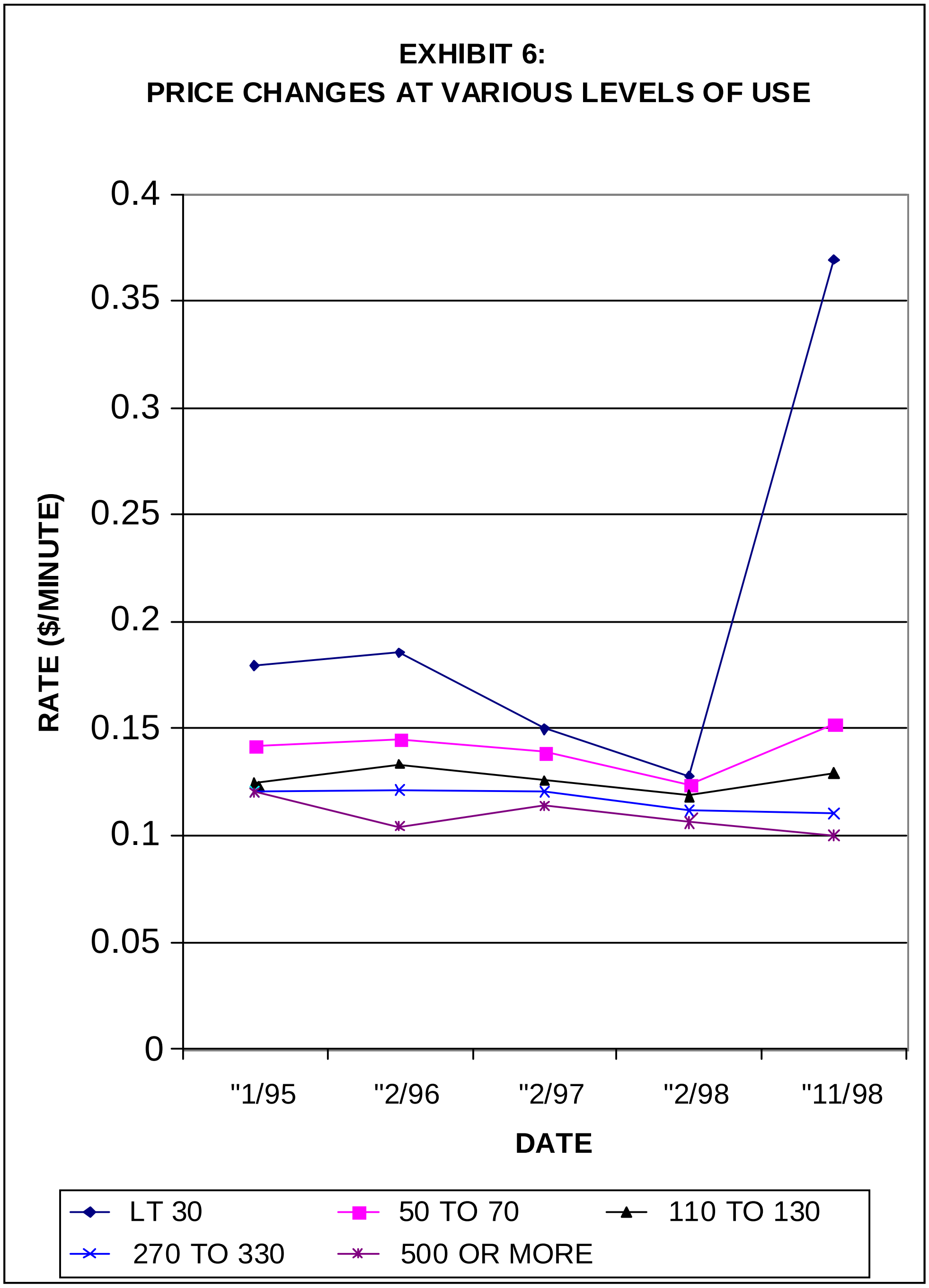
(a) Derived from Federal Communications Commission, <u>Trends in Telephone Service</u>, February 1999, Table 20.4, as described in text.

(b) Trends, Table 1.2.

(c) Trends, Table 1.2, adjusted for July 1, 1999 increases.



SOURCE: Bureau of Labor Statistics, *Consumer Price Index.*



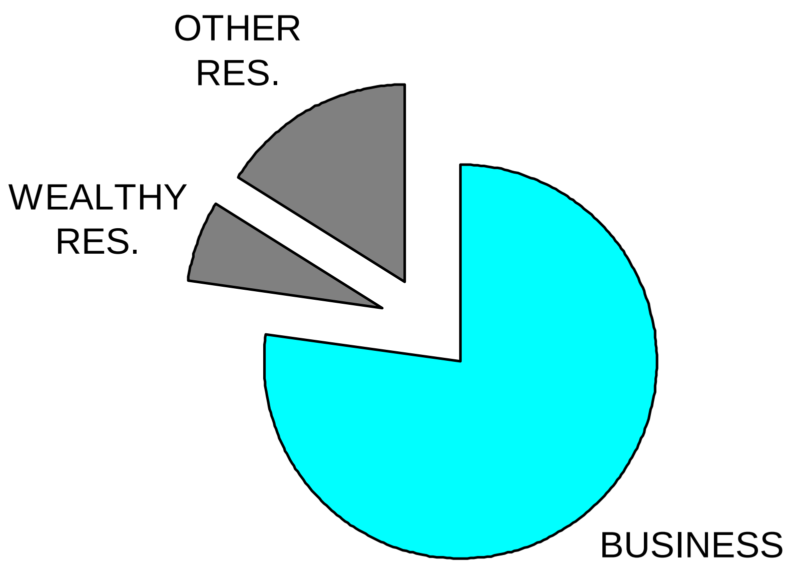
SOURCE: FCC, *Trends in Telephone Service*, June 1999, Table 2.4.

EXHIBIT 7

ESTIMATE OF INCREASE IN NET LONG DISTANCE BILLS
FOR RESIDENTIAL USERS WITH BELOW AVERAGE USAGE
CAUSED BY THE CALLS PROPOSAL
BASED ON THE 1998 EXPERIENCE OF ADDING PICC AND USF CHARGES
TO THE BOTTOM OF CONSUMER BILLS

LEVEL OF USE	MILLIONS OF HOUSEHOLDS	TOTAL ANNUAL INCREASE RESULTING INCREASES IN BOTTOM OF THE BILL CHARGES ($ MILLIONS	
		1998: $2.00 INCREASE (PICC AND USF ONLY, MUR NOT INCLUDED)	CALLS: $1.50
ZERO	15	$360	$252
1-30 MINUTES	15	360	252
30-50 MINUTES	20	454	318
50-75 MINUTES	20	454	318
TOTAL	70	1628	1140
NET OUT LIFELINE	5.4		91
NET INCREASE	64.6		1049

EXHIBIT 8
DISTRIBUTION OF GAINS ASSUMING EQUAL PASS THROUGH



SOURCE: See text for the derivation of these estimates.